S. HRG. 100-76

IMPROPER ACTIVITIES IN THE SECURITIES INDUSTRY

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE SECURITIES AND EXCHANGE COMMISSION RECENT ENFORCEMENT ACTIONS INVOLVING ALLEGATIONS OF INSIDER TRADING, MARKET MANIPULATIONS, FRAUDULENT CONDUCT, "PARKING" TRANSACTIONS, AND OTHER TYPES OF SECURITIES LAW VIOLATIONS

APRIL 22, 1987

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

72-963 WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S241-15

72-963 O - 87 - 1

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

ALAN CRANSTON, California
DONALD W. RIEGLE, JR., Michigan
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee
TERRY SANFORD, North Carolina
RICHARD SHELBY, Alabama
BOB GRAHAM, Florida

JAKE GARN, Utah
JOHN HEINZ, Pennsylvania
WILLIAM L. ARMSTRONG, Colorado
ALFONSE M. D'AMATO, New York
CHIC HECHT, Nevada
PHIL GRAMM, Texas
CHRISTOPHER S. BOND, Missouri
JOHN H. CHAFEE, Rhode Island

KENNETH A. MCLEAN, *Staff Director*
M. DANNY WALL, *Republican Staff Director*
STEVEN B. HARRIS, *Council*
THOMAS J. LYKOS, *Council*

CONTENTS

WEDNESDAY, APRIL 22, 1987

Page

Opening statement of Senator Proxmire 1
Opening statements of:
- Senator Heinz 2
- Senator Shelby 4
- Senator D'Amato 5
- Senator Riegle 7
- Senator Hecht 8
- Senator Garn 8
- Senator Dixon 10
- Senator Dodd 10
- Senator Sasser 11
- Senator Chafee 63

WITNESSES

Rudolph W. Giuliani, Esq., U.S. Attorney for the Southern District of New York 13
- No reaction in financial markets yet 13
- Criminal prosecutions for insider trading and related offenses 15
- Hostile and friendly takeovers 29
- Enforcement actions involving insider trading violations 36
- Greed was not the only motive 49
- Vigorous enforcement by SEC 50
- Criminal prosecutions should increase 51
- Mandatory minimum penalty 52
- Defining insider trading 53
- Response to written questions of Senator D'Amato 120

Gary Lynch, Director, Division of Enforcement, Securities and Exchange Commission, Washington, DC 54
- Magnitude and gravity of cases 54
- Insider trading and foreign countries 55
- Prepared statement 57
  - Recent cases 58
  - Other important insider trading cases 60
  - Conclusion 62
- Response to written questions of Senator D'Amato 129

Panel discussion:
- SEC resources 63
- Better self-policing 66
- Congress and insider trading 68
- Insider information 69
- Contributing factors for increased prosecutions 71
- Ethical values 72
- Longer prison terms 73
- Reform takeover law 75
- Other major cases this year 78
- Collusion 79
- Increased investigations 81
- Fiduciary duty 83
- Risk arbitrage 85
- Cooperation with investigators 87
- Chinese Wall 89
- Goldman-Sachs case 90

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

"Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation," a study by the Securities and Exchange Commission 94

IMPROPER ACTIVITIES IN THE SECURITIES INDUSTRY

WEDNESDAY, APRIL 22, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Dodd, Dixon, Sasser, Sanford, Shelby, Graham, Garn, Heinz, D'Amato, Hecht, Bond, and Chafee.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today the committee will hold a special hearing on some of the scandals shaking Wall Street. We are fortunate to have with us the two men who are the most responsible for bringing these scandals to the light of day.

Gary Lynch is the Director of Enforcement of the Securities and Exchange Commission, Rudolph Giuliani is the U.S. Attorney for the Southern District of New York.

Most of our securities laws were written in the 1930's in response to a series of abuses and scandals on Wall Street. These laws outlawed fraud and manipulation, required full disclosure and set up the Securities and Exchange Commission to enforce compliance. Because of these laws and their vigorous enforcement by the SEC, we now have the strongest capital markets in the world.

Lately, however, confidence in our capital markets has been shaken by a series of insider trading abuses involving some of the most respected names on Wall Street. Are these abuses simply isolated cases, or is there something systematically wrong with the way the securities business is conducted and regulated? How much do we really know about the corporate takeover game and the complex network of information that circulates among investment bankers, takeover lawyers, corporate raiders, arbitrageurs, stock brokers, junk bond investors and public relations specialists?

Is insider trading central to the takeover process, or is it merely an isolated abuse? How solid and how effective is the so-called Chinese Wall that separates merger and acquisition departments from risk arbitrage activities. Hopefully, these and other hearings will begin to shed some light on these questions.

There was another time when Congress confronted similar grave issues regarding the securities markets. In 1933 and 1934, a young attorney was recruited by this very Senate Banking Committee to probe the scandals of Wall Street. As a result of his efforts, white collar criminals were thrown into jail and Congress wrote new securities laws, widely acknowledged as the standard for the world. That man's name was Ferdinand Pecora.

Mr. Lynch and Mr. Giuliani, you are the Ferdinand Pecoras of the 1980's. Through your vigilance, Wall Street is being rid of some of its criminals whose greed has cut a sorry path through our American system.

Mr. Lynch, in your excellent statement for the committee, you discuss some of the reasons why insider trading is so hard to detect. You tell us that recent electronic surveillance, the ingenious use of computers, the cooperation with other countries, have all provided a basis for highlighting suspicious behavior. You conclude by remarking that recent action by the SEC in enforcing the securities laws has served notice on those who have attempted to violate the insider trading statutes, the possibility of detection has increased and the penalties for violation have also increased.

Some have argued that we should drop all laws that prohibit insider trading. They see insider trading as a function of the free market. They would argue that if the Boeskies and Levines clean up in the market to the tune of millions or hundreds of millions of dollars, they deserve every penny they can steal.

So you tell us, if you get a chance, why we, as Members of the Congress, should be concerned with insider trading, why we should have laws as least as strong as we presently have on the books to prevent it, and does insider trading, in fact, demean and damage the capital markets of our country?

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, thank you.

I would like to join you in welcoming our guests and congratulate you on this hearing, Mr. Chairman.

I am most interested in what our witnesses have to say, because what this committee needs to do is determine whether there is something inherently corrupting in the merger game and the way it is played. Are those who have been surfing the wave of merger mania in the stock market, the raiders, the arbitrageurs, the investment bankers, are they doing so on the up and up, or are they playing with a marked deck of cards? What is the industry doing to police itself? And more importantly, in the cases of outright insider trading, are the watchdogs—whether they are those of the public domain or others—doing everything that needs to be done about the abuses? Are we doing enough?

We've seen the headlines on the insider trading scandals—Wall Street's Watergate—the Boesky Affair, The Corruppies.

Beginning with Ivan Boesky, the public's witness that its knowledge on investment opportunities is not the same as those on Wall Street. Some, and perhaps it is more than we suspect, on Wall Street play the game on very difficult terms. Those that are the "in

crowd," so to speak, guided by the maxim that knowledge, whether ill-gotten or not, is power, and that is money.

Unfortunately, if you are not—or you haven't been part of the in crowd, you're out, out of business, out of the stock, out of the money.

Now perhaps former Gen. Omar Bradley was right when he said "The world has achieved brilliance without conscience. Ours is a world of nuclear giants and ethical infants," he said.

Well, whether you call what Dennis Levine and a small group of his associates did when they made millions purchasing the shares of companies that they knew that their own firms had targeted for takeover as a lapse in business ethics or simple fraud, there is a bigger question here than the profits they made. Their sweeping form of sophisticated fraud ripped off, not only the professional stock market players, but also the countless thousands of ordinary honest investors. It was these investors who contributed to the market in the form of their own stock purchases or in investments in pension and mutual funds that, in turn, had bought securities.

Why should the small investor have confidence in a system that treats them like crumbs in a big loaf of bread?

Unfortunately, the honest investors, in too many cases, have been the out crowd, and in my opinion, they have every reason to perceive that the market has been rigged against them, and quite frankly, I don't think that the SEC helped this perception when it allowed Boesky to trade on what I considered to be the biggest piece of insider information of all.

Beyond the fraud perpetrated on the American public, Mr. Chairman, the most tragic commentary on the Wall Street avarice that is so obvious is that the scandals we are reading about may simply be symptoms, not the disease. Too many investment bankers, too many lawyers, too many M.B.A's appear to be looking only for a fast buck profit, and yet the fast bucks are being made at the expense, I fear, of America's competitiveness and particularly our industrial competitiveness, because every fast buck used in a takeover battle, ending up as debt on the balance sheet of an acquirer, is a buck that cannot go into research or development or long-term planning or productivity enhancement. And today, at a time when all its energy and resources are needed for worldwide economic struggle, instead, American enterprise is increasingly being driven, it would appear, by a handful of opportunists, who have no interest in productive enterprise.

I don't think this country became great because it was great at shuffling paper assets around, and it seems to me that it is time for the executives on Wall Street or in the board room to devote more attention to productivity, market share and the other staples of good business, instead of trying to turn the grab business of buck artistry as their main business.

Mr. Chairman, I look forward to hearing from our witnesses.

The CHAIRMAN. Thank you, Senator Heinz. Senator Riegle has very graciously permitted us to call on Senator Shelby, who has a hearing he has to attend right away, so I will recognize Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Thank you, Mr. Chairman. I want to commend you, Mr. Chairman, for having this hearing today and for bringing before this committee two distinguished people that have been involved in insider trading, the U.S. attorney in New York, Mr. Giuliani and Gary Lynch, Director of the Enforcement Division of the Securities and Exchange Commission.

I would be remiss, if I didn't commend both of you for the job that you are doing. You have certainly taken the lead there. You have done a tremendous job.

Mr. Chairman, I believe that the real crime of the insider trading scandal is not just the callous disregard for the law, but the resulting shaken public confidence and trust in our financial and our capital formation system in this country. For this reason, I believe that much stiffer penalties should be imposed. Just because these individuals have white collars is no reason that they should be given what I would call the kid glove or easy treatment. I have reports that some of the individuals involved in this scandal have purchased $1 million homes even in the past few weeks. To me that seems quite ironic. These are serious crimes, which demand and deserve serious punishment, as the U.S. attorney here today has been involved in and knows.

I don't understand why these individuals, who have stolen millions of dollars, should be afforded better treatment than drug pushers and other lawbreakers in this country. I wish I could stay for the hearing today. I'll try to come back, if it comes on. Thank you, Mr. Chairman, for letting me go ahead.

The CHAIRMAN. Thank you, Senator Shelby. Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman. Mr. Chairman, I'd forego a lengthier statement and ask that it be placed in the record.

The CHAIRMAN. Without objection, it will be printed in full in the record.

Senator D'AMATO. Having done that, I am pleased and delighted to welcome two distinguished New Yorkers to the committee. I commend the chairman for calling this hearing. I would like to say that Gary Lynch, a native New Yorker and an alumnus of my alma mater, Syracuse, who also was somewhat shaken by that last-second shot that put Indiana over the top, has done an outstanding, outstanding job. It is my belief, and I know that the chairman shares this with me, that the SEC should have had more in the way of resources. I recall our hearings with Chairman Shad, when we spoke about the necessity of seeing to it that there was sufficient in the way of resources to do the job. Notwithstanding, I think they've done, with the available resources an effective, creditable job.

Rudy Giuliani—well, the superlatives could go on and on and on. He makes the news, the headlines, and I think it is important, because, hopefully, he sends a message out with the clear signal that the so-called "white collar" crime that does create a very substantial loss of confidence in our securities markets. That it will not be tolerated, that he will prosecute them vigorously, that they will get

substantial sentences, and that insider trading is not doing business as usual.

I look forward to an examination of a number of the key issues, such as, the imposition of civil penalties on the law firms, the securities firms. the banking firms, the corporations themselves who are involved in, mergers and acquisitions where these firms knew or should have known that their employees were engaged in insider trading. Should the firms then be held accountable?

Second, how effective are the regulatory surveillance systems which monitor the markets? Are the New York Stock Exchange and the other self-regulators doing adequate in their job?

And third, what effect does the increasing internationalization of the securities markets have on effective law enforcement of our securities markets? Will we witness the creation of the international thief? How do we move to protect ourselves in that area?

And so, Mr. Chairman, I look forward to hearing our two distinguished witnesses, and I again commend you and the committee for holding these hearings today.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. I welcome our two distinguished witnesses to the committee and state for the record what I have told them privately. I think they have done a superb job in tracking down and exterminating the white-collar rats that have tarnished the integrity of our securities markets. While some have attempted to belittle their efforts by claiming that all of their recent prosecutions were based on a lucky tip, those familiar with the details of the *Levine-Boesky-Siegel* cases know that these successful prosecutions were the culmination of a lot of hard work put in by both current and past members of the Enforcement Division and the U.S. Attorney's Office.

I also note for the record that the successes of our witnesses are predictable, if not inevitable. First, I note that Gary Lynch is an alumnus of my distinguished alma mater, Syracuse University. Second, Rudi Giuliani's nomination and confirmation to the important position of U.S. Attorney for the Southern District of New York is one which I endorsed and actively promoted. Whether prosecuting the war on drugs or white-collar crooks, Rudi has proven to be a worthy U.S. attorney.

I view today's hearing as a good news-bad news type of event. The good news is that we have before us, two very able prosecutors who have uncovered illegal trading activity which literally is conduct that shocks the conscience. The bad news is that many more prosecutions of leaders of corporate America and Wall Street may be forthcoming.

Recent revelations of illegal conduct in the marketplace are perhaps the most serious since the Stock Market Crash of 1929. Hearings in this committee during the 1930's uncovered revelations of stock manipulation, insider trading and other conduct now considered illegal that led to the passage of the Securities Exchange Act of 1934.

Although I do not believe that recently uncovered fraudulent activity in the marketplace is nearly as pervasive today as it was in

the 1920's, I believe that the recent insider trading cases demonstrate that Wall Street may be living up to our worst expectations. It seems that the dollar sign remains the only moral guidepost heeded by the so-called new breed of investment bankers and corporate leaders. Hopefully, the prosecutions of Levine and Boesky et al. and the legislation that may ultimately evolve from these hearings will instill a new sense of morality in these individuals charged with safeguarding the precious, yet intangible commodity, known as the investors confidence in the marketplace.

While the SEC's enforcement activity has sent shockwaves through Wall Street and corporate America, the SEC should be the last line of defense against illegal trading activity. The first line of defense must be at those investment and banking firms, corporations and law firms that regularly engage in the type of transactions that create opportunities for insider trading and market manipulation. To ensure that these firms have the incentive to implement self-policing mechanisms, I have introduced legislation that includes a provision which imposes civil money penalities against those firms who knew or should have known that their employees were trading on illegal inside information.

The second line of defense should be the market surveillance systems of the various self-regulatory organizations. We must examine the adequacy of these systems to determine whether they are effective in deterring, detecting, apprehending and prosecuting illegal trading. Effective surveillance systems are essential in today's expanding securities markets because individual investors must be confident that they are protected from the transgressions of large institutional insider trading and stock manipulation.

The third line of defense, the SEC, must be examined to determine how it can be made a more effective cop. My intuition is that more money is needed to police an ever expanding market. We need more cops on the beat rather than more rules for the cops to enforce. The penalities for insider trading are severe. The Insider Trading Sanctions Act which I sponsored increased threefold the civil penalties that can be imposed for insider trading.

However, due to the increasing internationalization of the securities markets, apprehending the sophisticated international crook is made difficult. The international problem is a major concern because our markets are subject to the most pernicious type of manipulation from offshore locations because these crooks may be beyond the reach of our laws. Steps must be taken and treaties must be signed to facilitate the SEC's prosecution of those who threaten the integrity of our markets from foreign locales.

I look forward to the testimony of these gentlemen and hope to work with them as closely in the future to resolve these problems as I have in the past. I also have some relevant materials, an SEC report and an analysis of recent insider trading cases demonstrating that recent insider trading activity is more likely to occur in friendly takeovers instead of hostile offers prepared by Tom Lykos, counsel to the Banking Committee, and Bob Casali, special assistant to the committee, which should be inserted in the record of this hearing at the appropriate place.

The CHAIRMAN. Thank you, Senator D'Amato. Senator Riegle.

OPENING STATEMENT OF SENATOR RIEGLE

Senator RIEGLE. Thank you, Mr. Chairman. I think if we look back in recent history, the United States gives the premier example of the most liquid, most efficient and the best capital market system that is found anywhere on the globe, and in very large measure, that has been due to the integrity of our marketplace and the securities laws which have evolved over time and which really shore up investor confidence.

As others have said, that confidence has been shaken by the disclosures of the last year or so, and they are a cause of great concern, not just on this committee but throughout the Senate. Colleagues come to me virtually every day and ask how we are proceeding with our efforts to try to move and take whatever steps are needed in this area. I think the point that Senator D'Amato makes about the internationalization of the capital markets, which is moving at an incredible rate of speed, raises these issues of confidence and integrity to a new level of difficulty. And it means, I think, that we not only have to be sure that our system here is as solid as we can make it, but I think we have to understand that we are moving into a new international 24-hour-a-day trading system that poses, I think, new challenges to us, in terms of being sure that we can say to people that our capital market system in this country is working properly and that shareholders and investors can have confidence in it.

Clearly, we cannot tolerate fraud or insider trading or market manipulation or any other violations of our securities laws. We are not going to tolerate them. They cannot be tolerated also in the sense that I think they pose an enormous jeopardy to the economic health of our country and to our future.

As a result of the cases that have already been brought by the SEC and by the U.S. Attorney's Office, that our free market system, our economy and the public, the investing public, are all much better off.

So I very much look forward to the testimony of our two witnesses today, and I want to commend them personally for their enforcement efforts and for their recent successes in bringing violators of the securities laws to justice. I can tell you this, the American people strongly support those efforts as they are ongoing, and they want them to be continued until every last instance of wrongdoing is uncovered and brought to light and that the people that have been involved in it are justly punished.

I don't think there should be any tolerance whatsoever for criminal activity in this area. In fact, I think well-educated, white collar criminals, in a sense, owe the country more than others, because they've had a much larger share of the advantages of this country. So when we see violations of the law of any kind by people in those favored situations, I think the full weight of the law has to come back the other way to address those issues.

I will have a series of specific questions today that I want to ask you that will not impinge at all on ongoing investigations. As chairman of the Securities Subcommittee, I am very much interested in your thoughts about whether our enforcement resources are adequate, do they need to be expanded, if so, to what extent? How

far along are we here in our investigative efforts? Are there other large and significant cases that are under way and that may come to fruition here at some point. As we try to draft legislative initiatives here, it is very important for us to know if we have seen the full range of what we are likely to see in the way of prosecutorial efforts, or are there other things of major consequence that may be coming that we should await, so that we have the full knowledge of what you are finding, before we attempt to move ahead ourselves.

So I will get into those detailed questions in short order. Thank you.

The CHAIRMAN. Thank you, Senator Riegle. Senator Hecht.

OPENING STATEMENT OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman. Mr. Chairman, I have been in the Senate over 4 years now, and one of the things I have found, that Congress always overreacts. When we look at what makes America different than any other countries, it is the ability to raise capital for American businesses, and with that, the highest standard of living in the world, the best wages and the best working conditions. Wall Street has served America very well, and before we undertake drastic changes, we should proceed with extreme caution.

It has been brought up constantly that our confidence has been shaken in Wall Street. I find that hard to believe, reading the morning paper and listening to the news last night, coming off the second largest volume day in history, the people were buying stocks, probably the largest volume in the last 3, 6 months, since these scandals have taken place.

One other point I have learned since I have been in the U.S. Senate after leaving the business world, we are making legislation or proposing legislation on American business, and I can say, without question, that the best business brains in America are not in the U.S. Congress. So I say, I will be anxious to hear from you, and I think we should proceed with extreme caution on any changes.

The CHAIRMAN. Thank you, Senator Hecht. Senator Garn.

Senator GARN. Thank you, Mr. Chairman. These are important hearings today, and I am anxious to hear the witnesses. I am also absolutely convinced that the statement I am about to make is true, that my colleagues did not come here today to listen to me and neither did all of these people. Therefore, I ask unanimous consent my statement be placed in the record.

The CHAIRMAN. Without objection.

STATEMENT OF SENATOR JAKE GARN

Senator GARN. Thank you Mr. Chairman. The focus of today's hearing will be in the area of security law violations and more specifically insider trading. I look forward to the testimony of the two enforcement officers most responsible for the recent revelations of abuse of the system that has served our Nation so well.

Our markets live or die on the principle that no one should deal from a stacked deck. Our securities laws are designed to require full disclosure and strict self-regulation by securities traders.

Today's hearing gives us a chance to test whether self-regulation and full disclosure are working. The impetus of this hearing for the Dennis Levine-Ivan Boesky-Martin Seigel scandal is an indication that those motivated by greed and lack of scruples can and will abuse the system. The SEC's and U.S. attorney's uncovering and prosecution of the corruption of Boesky and Levine and the inevitable additional prosecutions that will fall out of their conduct demonstrate that the current regulatory system is capable of uncovering fraud and manipulation, and that Federal law enforcement officials are determined to show the world that we will not tolerate pervasive insider trading in our securities markets.

But this episode also raises legitimate and disturbing questions that this committee must explore fully. How pervasive are these abuses? Does the SEC have the resources to assure that insider trading can be ferreted out and prosecuted whenever it occurs? Are the self-regulatory organizations doing what they need to do to police their members?

As I have said before, until all of the facts are in, we should not rush to judgment. Whatever we do today and in the future, Mr. Chairman, I think we must take care that in seeking to understand the problem and improve the system, we do not damage or destroy the SEC's current enforcement efforts or the vitality of our securities markets.

Therefore, I want to emphasize on behalf of all of my Republican colleagues that we attempt to avoid any comments or questions that might jeopardize the SEC's and the U.S. attorney's ongoing investigation. We are confident that our Members on the other side will do as well. We will be most vigilant and quick to note the committee's responsibilities in this area, Mr. Chairman.

Finally, despite the efforts of some to link insider trading abuses to the broader issue of hostile tender offers, I think intelligent and thoughtful observers realize that these are two distinct issues, and are best treated as such.

Again, I look forward to today's testimony. While I am very much impressed by the work and success of the investigations being conducted by these witnesses, I hope that their testimony will focus on helping this committee improve the system.

The CHAIRMAN. Senator Dixon.

Senator DIXON. Well, Mr. Chairman, you are certainly to be congratulated for holding these hearings, and I am delighted to have these distinguished witnesses before us this morning, and Mr. Chairman, I will ask that my statement be placed in the record in full. But I do want to comment, that I think there's a feeling in the country that this insider trading, market manipulation and securities fraud and other matters, have to be responded to in a very forceful way. I think there is a perception in the country that an ordinary person is prosecuted to the full extent of the law, but too often, the important influential people in this country are able to avoid the penalties they deserve, and so I am very anxious, Mr. Chairman, to have the benefit of the testimony of these witnesses and to support you in this committee in our effort to bring about the appropriate responses in our legal system.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the committee conducts oversight hearings on the SEC's efforts to contain improper activities in the securities markets.

I am very interested in learning the views of the SEC on the magnitude of the problem they are facing, and in knowing whether the Commission believes the problems are isolated or pervasive.

I have been alarmed by the seemingly unending cases of insider trading, market manipulation, securities fraud, and other violations of law that the SEC has uncovered in the recent past. Even more alarming is the fact that the violations seem to rise to the highest levels of the securities industry.

In my own view, the problems uncovered by the SEC demand legislative action. While I have the greatest respect for the SEC and its dedicated staff, I believe increasing enforcement efforts is only part of the solution. More fundamental reforms of the securities laws are clearly needed.

I look forward to hearing from our witnesses this morning, and to working with them and all interested parties in the development of a strong, reasonable, and effective package of legislative changes.

The CHAIRMAN. Thank you very much, Senator Dixon. I also have statements of Senators Dodd and Sasser to insert in the record at this point.

STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Mr. Chairman, I want to thank you for calling this hearing. I also want to thank our witnesses, Mr. Lynch and Mr. Giuliani, for appearing here today. Let me congratulate both of you on your recent successful enforcement efforts.

I must say, however, that I wish that it were not necessary to have today's hearing, or that perhaps we were here today congratulating you on preventing illegal activity in the securities markets, instead of apprehending law violators.

All of us who have observed the events since May last year have been shocked, disappointed and gravely concerned. We have seen some of the brightest minds on Wall Street charged, indicted and sent off the jail.

These events are especially disturbing, because of the critical function the securities industry serves in our economy. This industry stands at the center of the capital formation process, raising funds from millions of investors, who supply the capital necessary for thousands of businesses throughout our Nation. Investor confidence in the integrity of our markets is the oil that keeps this machinery going. And that confidence, in the past year, has been severely shaken.

We have seen securities professionals who have forgotten or ignored the special responsibilities they have to treat investors fairly. They have abused their positions of trust and confidence. They have stolen information and used it for their own financial gain. Ordinary investors cannot hope to compete with market professionals who trade on inside information or who manipulate the price of

securities. Increasingly, there is a perception that the markets are rigged and unfair.

All of us who sit on this committee understand our responsibility to do what is necessary to protect the integrity of our extraordinary capital markets in this country.

I know that Chairman Proxmire is developing legislation to address some of the abuses in the takeover process. I support that effort and intend to be very much involved in it.

Today, however, this hearing focuses on specific abuses in our markets—some of which happen in connection with hostile takeover activity but which also can happen apart from takeovers. I don't think any of us believe that simply stopping hostile takeovers will stop insider trading, market manipulation and other illegal activity in our securities markets.

I regret that I have to leave for a markup in the Foreign Relations Committee. I will return later if possible, but if I don't I hope the hearing record will explore at least some of the following questions:

1. We have seen a growing number of insider trading cases brought by the SEC and U.S. Attorney's Office in the past few years. Does this indicate that there is more fraud in the securities markets today than in the past? Does it mean that the high level of takeover activity has provided greater incentives for insider trading and other illegal activity? Does it mean that the SEC and Stock Exchanges are better able to detect this activity?

2. Does the increase in cases indicate the need for better enforcement tools? Does the SEC need more statutory authority, or more personnel? What can we in the Congress do legislatively to help?

3. Finally, we have seen our markets become increasingly institutionalized in recent years. The individual investor is playing a smaller and smaller role. Are we doing enough to protect the small investor, or are markets becoming an arena where only the big guys can safely play?

Again, Mr. Chairman I want to thank you for calling this hearing and thank the witnesses for appearing here today.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I am very pleased that this committee is going to take a hard look today at the insider trading and other abuses that are proliferating and spreading like cancer on Wall Street. I believe that it is critical that Congress make sure these abuses are addressed quickly and decisively. Too much is at stake for use to do otherwise.

What's at stake? The integrity of our stock market—the very foundation of America's capital raising process. Our Nation's ability to raise capital to create jobs for our workforce, and products and services for consumers, is dependent on the confidence of our investing public. Mr. Chairman, as you well know, that confidence is being severely tested by the scandalous activities we have witnessed recently.

According to a New York Stock Exchange survey, 42 million Americans directly invest in the stock market, while 130 million invest indirectly through pension funds and life insurance compa-

nies. It is estimated that half of the direct investors have portfolios of less than $5,000.

These investments are made under the expectation of fair treatment and access to all the material information necessary for rational investment decisions. They are not made with the knowledge that some persons will have information that average investors can never obtain. Mr. Chairman, our Nation's investors are at the mercy of an insider trading disease that makes a mockery of both fairness and the time-established principle of full disclosure of material information. Under these circumstances, how can, or why should, the average American participate in the stock market when a select few insiders have access to, or frankly—the ability to steal, superior information on market developments.

If our Nation's investors continue to be victimized, they will react and our system of capital allocation and the health of our economy will be seriously jeopardized.

Mr. Chairman, I'm concerned about insider trading and other market manipulative tactics for another reason relating to our Nation's economic well being. I believe that there's a strong connection between these activities and the wave of corporate takeovers we've seen over the past few years. These takeovers have leveraged our corporations with debt. They have resulted, in many cases, in forced restructurings of healthy companies, significant job losses and economic dislocation in numerous communities.

Certainly, takeovers have provided the major opportunity for insider trading to occur. Indeed, I am hopeful that yesterday's Supreme Court decision upholding an Indiana law will have positive results in protecting shareholders once a takeover begins. However, our existing Federal tender offer law still permits information relating to the occurrence of a takeover to remain secret for too long. It does not provide for sufficient disclosure of group activities. Today we have a situation where investment bankers, arbitrageurs, corporate raiders and law firms participate together in takeover activities. Huge sums of money hang in the balance. The possibility for insider abuses is enormous.

Mr. Chairman, I'm convinced that if we reform our tender offer law and act to curb insider trading and other market abuses, we will be going a long way toward limiting merger mania and restoring public confidence in the stock market. These are two actions which will be no short order. But I believe they are vital if we are to maintain the long term health of our economy.

To this end, I'm very interested in the testimony of our two distinguished witnesses. I believe that Mr. Lynch of the SEC and Mr. Giuliani, the U.S. attorney in New York, have done an excellent job. Their work is encouraging and I hope they'll be able to tell how we can make them even more effective.

The CHAIRMAN. Mr. Giuliani, we are delighted to have you. You have waited quite a while now to have an opportunity to testify, and we are certainly anxious to hear from you. Go right ahead, sir.

STATEMENT OF RUDOLPH W. GIULIANI, ESQUIRE, U. S. ATTORNEY FOR THE SOUTHERN DISTRICT OF NEW YORK, NY

Mr. GIULIANI. Mr. Chairman, it is a privilege to be here. The fairness and integrity of America's markets for capital formation are matters of prime importance, not only for our economy but also for America's overall future. Your concern and this committee's concern for the substantive problems and for approaches to substantive solutions to those problems is greatly appreciated by all of us.

The laws prohibiting insider trading now in existence for over half a century are crucial to assuring both the reality and the appearance of not only a free market but a fair market. You mentioned before that there is some debate about the need for insider trading legislation. Why do we need it? And it really is quite simple. If you use the analogy of gambling, which is a business that I occasionally have to investigate and prosecute also, you find that an awful lot of people gamble illegally on boxing matches, because they regard boxing matches as being not rigged, basically fair. They may be right; they may be wrong about that, but that is the perception. But nobody that I know has ever bet on a wrestling match in the last 20 or 30 years. [Laughter.]

It may be that wrestling matches are just as legitimate and just as honestly conducted as boxing matches, but at least the perception of the American public is that there is a material difference between the two. And if the perception ever becomes current, that the marketplace is being run the way wrestling matches are run, then, in fact, America will be in grave difficulty.

NO REACTION IN FINANCIAL MARKETS YET

Senator Hecht is quite correct in noting that the market has so far not reacted in a dramatic way to these disclosures, and let's hope that it doesn't, but as these things continue to be revealed, as the small investor and the medium-sized investor get the impression that their money is essentially being brought into a vacuum for those who are on the inside and have confidential information and are utilizing that information for their own personal benefit or for their firm's benefit or are engaged in other related kinds of crimes, related to the crime of insider trading, like stock manipulation and other failures to follow the requirements of the securities law, well, then, I think there could be a major problem with public confidence in the market and in the fairness and the freeness of the market, not just the fact that it's a free market.

Almost 1 year ago, in May 1986, with the arrest of Dennis Levine, public attention focused in a very dramatic way on the whole question of insider trading and related abuse in the marketplace. And I think, from the point of view of the public, many of them really believe that it began with that particular case. What I think might be helpful, if I just spend a minute focusing on the cases that took place before the Dennis Levine case, because from my perspective and from my point of view, it was sometime before the Dennis Levine case that I first began to realize that the problem of insider trading was not an isolated problem, was not the problem of one or two investment bankers or lawyers or others

who came upon inside information and fell prey to the temptation of trading on it in an abusive way, but that, in fact, it had become a problem.

The way that I came to that realization, personally, is with a chart that we submitted to the committee, and that I would ask be made part of the record.

The CHAIRMAN. Without objection, it will be included in the record.

[Material submitted for the record follows:]

CMC:ee
F-84/2

UNITED STATES ATTORNEY SOUTHERN DISTRICT OF NEW YORK
CRIMINAL PROSECUTIONS FOR INSIDER TRADING AND RELATED OFFENSES
(By Occupation; as of 3/17/87)

DEFENDANT	FIRM	DOCKET	STATUS	DATE
A. CORPORATE OFFICERS AND DIRECTORS				
1. DARIUS N. KEATON (Director)	SANTA FE INT'L CORP.	SS86 Cr. 50 (WK)	Pleaded guilty; awaiting sentence	2/13/87
B. INVESTMENT BANKERS				
2. E. JACQUES COURTOIS (Vice President in Mergers & Acquisitions)	MORGAN STANLEY & CO., INC.	SSS81 Cr. 53 (CSH)	Sentenced to 6 months imprisonment	2/13/84
3. ADRIAN ANTONIU (Associate)	MORGAN STANLEY & CO., INC. and KUHN LOEB & CO.	80 Cr. 742 (CES)	Sentenced to 39 months probation $5000 fine*	8/11/82
4. JAMES PONDICCIO (Trader with Lazard)	LAZARD FRERES & CO.	84 Cr. 9 (CSH)	Sentenced to 3 years probation	3/9/84
5. DENNIS B. LEVINE (Managing Director formerly with Shearson Lehman Brothers)	DREXEL BURNHAM LAMBERT INC.	86 Cr. 519 (GLG)	Sentenced to 2 years imprisonment, $362,000 fine*	2/20/87

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
6.	IRA SOKOLOW (Vice President)	SHEARSON LEHMAN BROTHERS	86 Cr. 862 (JFK)	Sentenced to 1 year and 1 day in jail; 3 years probation*	11/6/86
7.	DAVID S. BROWN (Vice President)	GOLDMAN SACHS & CO.	86 Cr. 861 (JFK)	30 days imprisonment; 300 hours community service; $10,000 fine*	1/12/87
8.	ROBERT WILKIS (Vice President, E.F. Hutton)	E.F. HUTTON; LAZARD FRERES	86 Cr. 1112 (PKL)	Sentenced to 1 year and 1 day in jail; 5 years probation*	2/9/87
9.	RANDALL D. CECOLA** (Analyst)	LAZARD FRERES	86 Cr. 1113 (PKL)	5 years probation	2/10/87
10.	MARTIN SIEGEL (Director)	KIDDER, PEABODY & CO.	87 Cr. 118 (RJW)	Pleaded guilty; awaiting sentence	2/13/87

16

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

** Pleaded guilty to tax changes arising from insider trading investigation.

CMC:ee
F-84/2

DEFENDANT	FIRM	DOCKET	STATUS	DATE
C. ARBITRAGEURS				
11. ANDREW SOLOMON (Analyst; previously an attorney)	MARCUS SCHLOSS & CO., INC.	86 Cr. 451 (GLG)	Sentence to 1 year probation, $10,000 fine, 250 hours community service*	11/26/86
12. ROBERT SALSBURY (Analyst)	DREXEL BURNHAM LAMBERT INC.	86 Cr. 453 (GLG)	Sentenced to 3 years probation, 200 hours community service*	12/2/86
13. TIMOTHY L. TABOR (Formerly a Vice-President of Kidder, Peabody & Co.)	MERRILL LYNCH, PIERCE, FENNER & SMITH	87 Cr.	Criminal Complaint filed	2/12/87
14. RICHARD WIGTON (Vice-President; head of risk arbitrage department)	KIDDER PEABODY & CO.	87 Cr.	Criminal Complaint filed	2/12/87
15. ROBERT M. FREEMAN (Partner; head of risk arbitrage department)	GOLDMAN, SACHS & CO.	87 Cr.	Criminal Complaint filed	2/12/87

17

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
D.	LAW FIRMS -- ATTORNEYS AND STAFF				
16.	DAVID HALL (Attorney)	DEMAS & HALL	80 Cr. 692 (CES)	Sentenced to 25 days in jail 2 years probation	12/23/80
17.	CARLO FLORENTINO (Attorney at Wachtell and Davis Polk)	WACHTELL, LIPTON, ROSEN & KATZ and DAVIS POLK & WARDWELL	82 Cr. 450 (WCC)	Sentenced to 2 years probation	10/04/82
18.	KENNETH RUBINSTEIN (Attorney)	FRIED, FRANK, HARRIS, SHRIVER & JACOBSON	83 Cr. 474 (MEL)	Sentenced to 30 months probation	9/23/83
19.	ISRAEL GROSSMAN (Attorney formerly with Kramer, Levin, Nessen & Kamin)	CARTER, LEDYARD & MILBURN	87 Cr. 223 (RO)	Indictment filed; awaiting trial	3/17/87
20.	STEVEN MATTHEWS CROW (Computer/Word Processor)	SKADDEN, ARPS, SLATE, MEAGHER & FLOM	84 Cr. 239 (WK)	Sentenced to 2 years' probation, restitution, and 150 hours of community service each year of probation*	10/04/84

18

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

DEFENDANT	FIRM	DOCKET	STATUS	DATE
21. ALFRED SALVATORE (Proof Reader)	SKADDEN, ARPS, SLATE, MEAGHER & FLOM	84 Cr. 260 (WK)	Sentenced to 3 years' probation, restitution, and 150 hours of community service each year of probation	10/04/84
22. KENNETH PETRICIG (Proof Reader)	SKADDEN, ARPS, SLATE, MEAGHER & FLOM	84 Cr. 256 (WK)	Sentenced to 3 years' probation, restitution, and 150 hours of community service each year of probation*	10/04/84
23. ALAN IHNE (Manager of Office Services)	SULLIVAN & CROMWELL	84 Cr. 686 (CLB)	Sentenced to 3½ years imprisonment plus 5 years probation	06/14/85
24. MANOHAR LAL MADAN (Word Processor)	WACHTELL, LIPTON, ROSEN & KATZ	85 Cr. 1076 (WK)	Sentenced to 6 months imprisonment plus 3 years probation	07/28/86
25. CHRISTOPHER MOFFATT (Accounting Clerk)	SULLIVAN & CROMWELL	85 Cr. 1113 (LBS)	Sentenced to 3 years' probation	12/06/85

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
26.	LEONARD DIRUSSO (Facilities and Purchasing Manager)	SULLIVAN & CROMWELL	85 Cr. 1113 (LBS)	Sentenced to 3 years' probation	12/06/85
27.	MICHAEL DAVID (Associate Attorney)	PAUL, WEISS, RIFKIND, WHARTON & GARRISON	86 Cr. 454 (JFK)	Pleaded guilty; awaiting sentence	11/26/86
28.	ILAN REICH (Partner; Levine tippee)	WACHTELL, LIPTON, ROSEN & KATZ	86 Cr. 863 (RWS)	Sentenced to 1 year and 1 day; 5 years probation	1/23/87
29.	DAVID W.C. CLARK (Partner)	APPLETON, RICE & PERRIN	87 Cr. 49	Indicted; awaiting trial	1/21/87
E.	ACCOUNTING FIRM				
30.	HOWARD L. DAVIDOWITZ (a principal and Chairman of Ernst & Whinney's Retail Consulting Services Program)	ERNST & WHINNEY	82 Cr. 846 (JES)	Sentenced to 39 weekends imprisonment $10,000 fine 5 years probation	02/02/83

20

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
F.	STOCK BROKERS/OTHER SECURITIES PROFESSIONALS				
31.	JAMES M. NEWMAN (Stockbroker; tippee of Antoniu and Courtois in Morgan Stanley-Kuhn Loeb case)	EXECUTIVE SECURITIES	82 Cr. 166 (CSH)	Sentenced to 1 year plus 1 day imprisonment 3 years' probation $10,000 fine	07/16/82
32.	BRUCE PAUL** (Stockbroker; tippee in Morgan Stanley-Kuhn Loeb investigation)	EDWARD A. VINER & CO., INC.	S 83 Cr. 14 (RJW)	Sentenced to 3 years' probation	05/04/83
33.	JAMES L. COVELLO (Bond Trader, tippee in Sullivan & Cromwell investigation)	GINTEL & CO.	84 Cr. 204 (MEL)	Sentenced to 3 years' probation and 630 hours of community service	02/07/85
34.	AARON LERMAN (Stockbroker; tippee in Skadden, Arps investigation)	PRUDENTIAL-BACHE	84 Cr. 283 (CLB)	Sentenced to 6 months' imprisonment, 4 years' probation and 200 hours community service	11/01/84

21

** Bruce Paul pleaded guilty to two counts of filing false tax returns in the middle of his trial on tax and perjury charges arising from the Morgan Stanley-Kuhn Loeb investigation.

CHC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
35.	PETER M. BRANT (Stockbroker; tippee in Wall Street Journal investigation)	KIDDER, PEABODY & CO. INCORPORATED	84 Cr. 470 (ADS)	Awaiting Sentence*	Pleaded Guilty 07/12/84
36.	GIUSEPPE TOME (Branch Manager in Geneva, Switzerland; financial consultant to Joseph E. Seagram & Sons, Inc.; accused of trading on inside information stolen from Seagram)	BAIRD-PATRICK & CO., INC.	84 Cr. 534 (SWK)	Indicted; currently a fugitive in Europe	08/07/84
37.	KENNETH P. FELIS (Stockbroker; tippee in Wall Street Journal investigation)	KIDDER, PEABODY & CO. INCORPORATED	84 Cr. 605 (CES)	Sentenced to six months imprisonment $25,000 fine 5 years' probation 500 hours community service	08/07/85
38.	HOWARD ROSSMAN (Stockbroker; tippee in Bowne investigation)	PRUDENTIAL-BACHE	84 Cr. 707 (CES)	Sentenced to 3 years probation conditioned on his not working in the securities industry, plus 400 hours community service	06/13/86

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
39.	ROBERT D'ELIA (Stockbroker; tippee in Bowne investigation)	PRUDENTIAL-BACHE	84 Cr. 707 (CES)	Sentenced to 3 years probation, a $30,000 fine and 1000 hours community service	06/23/86
40.	JAMES STIVALETTI (Stockbroker; tippee in Sullivan & Cromwell)	BOND RICHMAN & CO., INC.	84 Cr. 686 (CLB)	Sentenced to 2½ years' imprisonment $10,000 fine plus 5 years probation	07/11/85
41.	EUGENE CHIARAMONTE** (Stockbroker; tippee in Sullivan & Cromwell investigation)	BOND RICHMAN & CO., INC. PAUL L. FORCHHEIMER & CO.	84 Cr. 686 (CLB)	Sentenced to 18 months' imprisonment plus $10,000 fine	06/14/85
42.	DAVID RAPAPORT** (Stockbroker; tippee in Sullivan & Cromwell investigation)	BOND RICHMAN & CO., INC. PAUL L. FORCHHEIMER & CO.	S 84 Cr. 686 (CLB)	Sentenced to 6 months' imprisonment plus $10,000 fine	06/14/85

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

** Pleaded guilty to tax charges arising from insider trading investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
43.	MORTON SHAPIRO (Stockbroker; tippee in Paul, Weiss investigation)	MOSELEY, HALLGARTEN, ESTABROOK & WEEDEN, INC.	86 Cr. 455 (GLG)	Sentenced to 2 months imprisonment; $25,000 fine.*	3/2/87
G.	FINANCIAL PRINTERS				
44.	VINCENT CHIARELLA	PANDICK PRESS	78 Cr. 2 (RO)	Sentence to 1 month imprisonment, 5 years' probation; vacated by the Supreme Court	03/18/80
45.	CLARENCE ABRAMSON	BOWNE & CO.	84 Cr. 487 (ADS)	sentenced to 3 years probation and 300 hrs. a year community service.	6/26/86
46.	CHARLES GARBER	BOWNE & CO.	84 Cr. 541 (WK)	Sentenced to 3 years' probation 300 hours community service	12/20/84

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and couperated in the investigation.

CMC:ce
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
47.	ANTHONY MATERIA	BOWNE & CO.	84 Cr. 985 (PNL)	Sentenced to 5 months' imprisonment 4 years' probation 400 hours community service	06/21/85
H.	MISCELLANEOUS				
48.	CONSTANTINE SPYROPOLOUS (Tippee in Morgan Stanley-Kuhn Loeb investigation)	ENGINEER	82 Cr. 166 (CSH)	Sentenced to 3 years' probation; $10,000 fine*	04/12/83
49.	FRANKLIN CARNIOL (Tippee in Morgan Stanley-Kuhn Loeb investigation)	ENGINEER SALES MANAGER FOR ITT and WESTINGHOUSE	82 Cr. 166 (CSH)	Sentenced to 3 years' probation; 500 hours community service	09/20/85

25

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
50.	STEVEN NUSSBAUM (Tippee in Morgan Stanley-Kuhn Loeb investigation)	DENTIST	81 Cr. 672 (JMC)	Sentenced to 5 years probation $10,000 fine*	04/26/83
51.	STEPHEN L. WALLIS (Tippee in Skadden Arps investigation)	CABDRIVER	84 Cr. 521 (WCC)	Sentenced to weekends in prison for 18 months; 5 years probation; $49,000 restitution	09/18/84
52.	SHARON WILLEY (Tippee in Skadden Arps investigation)	RECEPTIONIST	84 Cr. 521 (WCC)	Sentenced to 5 years probation $34,000 restitution	09/18/84
53.	R. FOSTER WINANS (Newspaper reporter)	WALL STREET JOURNAL	84 Cr. 605 (CES)	Sentenced to 18 months imprisonment $5,000 fine 5 years' probation 400 hours community service	08/06/85
54.	DAVID CARPENTER (Tippee in Wall Street Journal investigation)	UNEMPLOYED	84 Cr. 605 (CES)	Sentenced to $1,000 fine 3 years' probation 200 hours community service	08/06/85

26

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

CMC:ee
F-84/2

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
55.	THOMAS C. REED (Charged with trading on information received from an AMAX director)	PRIVATE INVESTOR; former Secretary of the Air Force and National Security Advisor	84 Cr. 618 (RJW)	Acquitted	12/16/85
56.	JOSEPH PALOMBA (Tippee in Sullivan & Cromwell investigation)	UNEMPLOYED	84 Cr. 673 (LBS)	Sentenced to 3 years probation*	07/09/85
57.	MICHAEL MUSELLA** (Tippee in Sullivan & Cromwell investigation)***	FACTORY MUTUAL ENGINEERING	85 Cr. 590 (TCP) (E.D.N.Y.)	Sentenced to 3 years' probation; $2,500 fine	Convicted at trial on 12/03/85

27

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

** Michael and John Musella were named in indictments and convicted at trial by this Office in the Eastern District of New York for tax offenses arising from the Sullivan & Cromwell investigation.

*** Three other individuals, Albert DeAngelis, former Teamsters Local President, Anthony Brunetti, an insurance agent, and Thomas DiSpigno, a Citibank employee, were indicted as tippees in the Sullivan and Cromwell investigation, but the Government dismissed the charges prior to trial.

	DEFENDANT	FIRM	DOCKET	STATUS	DATE
58.	JOHN MUSELLA** (Tippee in Sullivan & Cromwell investigation)	NEW YORK CITY POLICE OFFICER	85 Cr. 404 (MAC) (E.D.N.Y.)	Sentenced to 3 years' probation	12/10/85
59.	ALBERT D'ELIA (Tippee in Bowne investigation)	BERMCO PAPER COMPANY	84 Cr. 707 (CFS)	Sentenced to 3 years probation and a $10,000 fine	06/13/86
60.	KRISHAN TANEJA Employee	OFFICE OF MANHATTAN BOROUGH PRESIDENT; OWNER OF INVESTMENT ADVISORY SERVICE	86 Cr. 202 (RJW)	Sentenced to 6 months imprisonment plus 3 years Probation	03/06/86
61.	DANIEL J. SILVERMAN (tippee in Paul, Weiss investigation)	INVESTOR	86 Cr. 452 (GLG)	Sentenced to 3 years probation; 200 hours community service; $25,000 fine*	3/2/87
62.	COSTANDI N. NASSER (tippee in Santa Fe investigation)	INVESTOR; SELF-EMPLOYED	86 Cr.639	Indicted; Currently a fugitive in Europe	07/29/86

28

---

* Sentences denoted by an asterisk are cases where the defendant pleaded guilty and cooperated in the investigation.

** Michael and John Musella were named in indictments and convicted at trial by this Office in the Eastern District of New York for tax offenses arising from the Sullivan & Cromwell investigation.

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	LBO
Ivan Boesky	Ivan Boesky Corp.	American National Resources Corp.	3/1/85, cash tender offer by Coastal Corp.	x		
		Houston Natural Gas	5/2/85, merger offer by Internorth		x	
		Nabisco	5/30/85, merger with R. J. Reynolds		x	
		General Foods	9/27/85, tender offer by Philip Morris Cos.		x	
		Union Carbide	12/9/85, tender offer by GAF	x		
		FMC	2/21/86, reorganization plan announced	-	-	-
		Bendix Corp.	8/30/82 tender offer by by Martin Marietta	x	x (Allied White Knight)	
		Pargas Inc.	acquisition by Freeport-McMoRan Inc.	Freeport-McMoran did not acquire Pargas		
		Natomas Inc.	5/83 tender offer by Diamond Shamrock	x (deal later done on a friendly basis)		
		Getty Oil Co.	9/83 possible change in Corporate Control	x		
		Midlands Energy Co.	Takeover bid considered by Evmar	x	x (Acq. by Freeport-MacMoran)	
		Carnation Co.	4/84 acquisition by Nestle S.A.		x	

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	LBO
Martin Siegel	Kidder Peabody & Co., Inc.	Bendix Corp.	8/30/82 tender offer by by Martin Marietta	x	x (Allied White Knight)	
		Pargas Inc.	acquisition by Freeport-McMoRan Inc.	No such acquisition		
		Natomas Inc.	5/83 tender offer by Diamond Shamrock	x (deal later done on a friendly basis)		
		Getty Oil Co.	9/83 possible change in Corporate Control	x		
		Midlands Energy Co.	Takeover bid	x considered by Evmar	x acquisition by Freeport-MacMoran	
		Carnation Co.	4/84 acquisition by Nestle S.A.		x	
Dennis Levine	Smith Barney Harris Upham & Co.	Dart Industries	6/6/80, merger offer by Kraft, Inc.		x	
		NN Corp.	7/24/80, Acquisition bid Engelhard Minerals and Chemical Corp.		x	
		Huyck Corp.	7/29/80, Merger Offer by Wheelabrator-Frye Inc.		x	
		Jefferson National Life Insurance Co.	9/26/80, Acquisition talks with Zurich Insurance Co.		x	

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	LBO
		Hobart Corp.	2/18/81, Merger offer by Dart & Kraft, Inc.		x	
		Wallace Murray Corp.	2/18/81, Acquisition Offer by Household Finance Corp.		x	
		Day Mines Inc.	3/23/81, Merger Offer by Becla Mining Co.	x		
		Reliance Universal Inc.	4/13/81, Tender Offer by Tyler Corp.		x	
		Flagship Bank Inc.	6/3€/81, Acquisition talks with Royal Trustco Ltd.		x	
		Ludlow Corp.	8/18/81, Acquisition bid by Bairnco Corp.		x	
		Sunbeam Corp.	9/22/81, Acquisition bid by IC Industries Inc.	x		
	Lehman Brothers Kuhn Loeb Inc.	Kent-Moore Corp.	11/9/81, Tender Offer by Sealed Power Corp.		x	
		Four-Phase Systems, Inc.	12/11/81, Acquisition bid by Motorola Inc.		x	
		Supron Energy Corp.	2/11/82, Joint tender offer by Allied Corp./ Continental Group Inc.		x	
		Marshall Field & Co.	3/17/82, Tender Offer by B.A.T. Industries		x	

3/10/86

Securities and Exchange Commission
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1980 - September 30, 1981

1. ANTEBI, STEVEN SOLOMON (In the Matter of), Exchange Act Release No. 17798 (May 12, 1981) [See Liederman, Donald E., infra.]

2. BANCA DELLA SVIZZERA ITALIANA, Irving Trust Company, et al. (SEC v.), Civil Action No. 81-1836 (S.D.N.Y., filed March 27, 1981) [Lit. Rel. Nos. 9334, 9420, 11120 and 11320].

3. DAVIDOWITZ, HOWARD L. (SEC v.), Civil Action No. 81-4857 (S.D.N.Y., filed August 6, 1981) [Lit. Rel. No. 9413].

4. FINAMERICA CORPORATION and Jorge E. Carnicero (SEC v.), Civil Action No. 81-0553 (D.D.C., filed March 9, 1981) [Lit. Rel. No. 9317].

5. FLORENTINO, CARLO M. (SEC v.), Civil Action No. 81-5903 (S.D.N.Y., filed September 23, 1981) [Lit. Rel. Nos. 9456 10095]. (See also LR-9778 for criminal action.)

6. HEWETT, HERBERT F. (SEC v.), Civil Action No. 81-127D (W.D. Okla., filed February 5, 1981) [Lit. Rel. No. 9290].

7. LIEDERMAN, DONALD E., Capital Energy Corporation, Hartley Lord, Richard J. Werdesheim, Steven Antebi, James Sale, Joseph Bishop, Eugene Faierman, and Michael Savage (SEC v.), Civil Action No. 81-2315 (C.D. Cal., filed May 12, 1981) [Lit. Rel. Nos. 9360 and 9450].

8. LUND, LAVERNE GILBERT and Estle Finney (SEC v.), Civil Action No. 81-0371 (C.D. Cal., filed January 28, 1981) [Lit. Rel. No. 9278].

9. MacCONNELL, GROVER, A. L. Williamson & Co., Douglas Grobe, and Donald Messenger (SEC v.), Civil Action No. 81-2575 (D.N.J., filed August 12, 1981) [Lit. Rel. Nos. 9419, 9479 and 9573].

10. NAHABEDIAN, ARAMIS M.K., Michael R. Simonian, Joe W. Floyd, Glenn W. Patterson, Jack Severns, Jack R. Andrews, Andrew J. Macht, and Raymond S. Blunk (SEC v.), Civil Action No. 80-5280 (C.D. Cal., filed November 25, 1980) [Lit. Rel. No. 9250].

11. O'CONNELL, DANIEL H. and Arthur D. Tanner (SEC v.), Civil Action No. 80-6183 (S.D.N.Y., filed October 30, 1980) [Lit. Rel. No. 9222].

12. WYMAN, FRANK H. (SEC v.), Civil Action No. 81-1025 (S.D.N.Y., filed February 20, 1981) [Lit. Rel. No. 9311].

13. WYMAN, FREDERICK, II (SEC v.), Civil Action No. 81-1026 (S.D.N.Y., filed February 20, 1981) [Lit. Rel. No. 9312].

12/10/86

Securities and Exchange Commission
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1981 - September 30, 1982

1. ANDES, CHARLES L., Brian G. Harrison, Nelson B. Colton, and James M. Doyle (SEC v.), Civil Action No. 82-1659 (E.D. Pa., filed April 14, 1982) [Lit. Rel. No. 9649].

2. BARANOWICZ, ISAAC, William A. Mallet, and Tze-Tung Chang a/k/a/ Michael Chang (SEC v.), Civil Action No. 82-3082 (C.D. Cal., filed June 21, 1982) [Lit. Rel. No. 9704].

3. BINDER, AARON M. (SEC v.), Civil Action No. 81-5209 (C.D. Cal., filed October 8, 1981) [Lit. Rel. No. 9471].

4. CERTAIN UNKNOWN PURCHASERS (SEC v.), Civil Action No. 81-6553 (S.D.N.Y., filed October 26, 1981) [Lit. Rel. Nos. 9484, 9485, 10295 and 11012].

5. CHRISTOPH SECURITIES INC. and Richard T. Christoph (SEC v.), Civil Action No. 82-2216 (N.D. Ill., filed April 12, 1982) [Lit. Rel. No. 9644].

6. COOPER, MARTIN W., William J. Chadwick, and James D. Hutchinson (SEC v.), Civil Action No. 82-3462 (C.D. Cal., filed July 15, 1982) [Lit. Rel. No. 9718].

7. DOVE, GUY O., III (SEC v.), Civil Action No. 82-1522 (D.D.C., filed June 3, 1982) [Lit. Rel. No. 9685].

8. FABREGAS, J. ROBERT and Stephen W. Porter (SEC v.), Civil Action No. 82-3440 (C.D. Cal., filed July 14, 1982) [Lit. Rel. No. 9717].

9. FEOLE, RONALD A., Jacqueline Feole, Tim Snitko, Mitchell Snitko, Joseph Riggio and Mavoureen Sickler (SEC v.), Civil Action No. 82-5018 (C.D. Cal., filed September 28, 1982) [Lit. Rel. No. 9767].

10. MARTIN GARY L., Martin & Martin, M & M Investments, and Gary L. Martin, Inc., P.S. (SEC v.), Civil Action No. 82-381 (W.D. Wa., filed April 7, 1982) [Lit. Rel. Nos. 9642 and 11065].

11. MATERIA, ANTHONY and Concetta Materia (SEC v.), Civil Action No. 82-6225 (S.D.N.Y., filed September 20, 1982) [Lit. Rel. Nos. 9789 and 9789A].

12. RANDOLPH, JAMES H., JR. and Charles Blackard (SEC v.), Civil Action No. 82-5343 (N.D. Cal., filed September 30, 1982) [Lit. Rel. No. 9781].

13. REED, THOMAS C. and Frank W. Woods (SEC v.), Civil Action No. 81-7984 (S.D.N.Y., filed December 23, 1981) [Lit. Rel. No. 9537].

14. RUBINSTEIN, KENNETH and Aaron Rubinstein (SEC v.), Civil Action No. 82-4043 (S.D.N.Y., filed June 21, 1982) [Lit. Rel. No. 9708].

15. SAUNDERS, MARK C. (SEC v.), Civil Action No. 82-0354 (E.D. Va., filed April 19, 1982) [Lit. Rel. Nos. 9651 and 9768].

16. SCHAFER, THOMAS W. (SEC v.), Civil Action No. 81-6225 (S.D.N.Y., filed November 25, 1981) [No Lit. Rel. No. See Attachment].

17. SCHWARTZ, HAROLD, Robert E. Gyemant and Paul J. Keil (SEC v.), Civil Action No. 82-0457 (N.D. Cal., filed January 25, 1982) [Lit. Rel. No. 9571].

18. SHARON STEEL CORPORATION (Investigative Report Pursuant to Section 21(a) of the Exchange Act), Exchange Act Release No. 18271 (November 19, 1981).

19. VOIGT, ROBERT A., Thomas Voigt, John Deuser, Larry Hall, Edwin Jacobs, James O'Bryan, and Jerome Shoen (SEC v.), Civil Action No. 82-344 (S.D. Ind., filed March 12, 1982) [Lit. Rel. No. 9613].

20. WULFF HANSEN & CO., Keith E. Wentz, and Ronald P. Bynum (In the Matter of), Exchange Act Release Nos. 19080 (September 27, 1982) and 19081 (September 27, 1982).

12/10/86

Securities and Exchange Commission
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1982 - September 30, 1983

1. BAUER, FRANK JOSEPH (In the Matter of), Exchange Act Rel. No. 20099 (August 18, 1983).

2. CARMICHAEL, ROBERT W., Anton H. Maurer and Henry P. Carmichael (SEC v.), Civil Action No. 83-5958 (S.D.N.Y., filed August 16, 1983) [Lit. Rel. No. 10094].

3. CLEMENTS, JOHN and R. James Royer (SEC v.), Civil Action No. 82-3604 (D.D.C., filed December 20, 1982) [Lit. Rel. No. 9844].

4. DeYOUNG, JAMES (SEC v.), Civil Action No. 83-2234 (D.D.C., filed August 4, 1983) [Lit. Rel. No. 10084].

5. GASPAR, GEORGE J., Joseph F. Schreck, Todd B. Marsh, Lawrence K. Marsh, Eugene L. Hall, Kim B. Stirea, Donald Ritgor, Kenneth Leach, and Mark Yager (SEC v.), Civil Action No. 83-3037 (S.D.N.Y., filed April 20, 1983) [Lit. Rel. Nos. 9970, 10007 and 10730]. (Litigated Decision)

6. G. HEILEMAN BREWING COMPANY (SEC v.), Civil Action No. 83-834 (E.D. Wis., filed June 29, 1983) [Lit. Rel. No. 10049].

7. GRIFFITH, BARRY T. and Thomas Griffith (SEC v.), Civil Action No. 83-1316A (N.D. Ga., filed June 23, 1983) [Lit. Rel. No. 10072].

8. GROTH, DENNIS DALE (SEC v.), Civil Action No. 83-4534 (N.D. Ca., filed September 26, 1983) [Lit. Rel. Nos. 10138 and 10408].

9. HALL, JOSEPH E. (SEC v.), Civil Action No. 83-6904 (S.D.N.Y., filed September 21, 1983) [Lit. Rel. No. 10129].

10. JOHNSON, ROBERT E. (SEC v.), Civil Action No. 3-83-0257G (N.D. Tex., filed February 11, 1983) [Lit. Rel. No. 9899].

11. KAPACHUNES, FRANCES and Michael Kotwasinski (SEC v.), Civil Action No. 83-5368 (S.D.N.Y., filed July 21, 1983) [Lit. Rel. No. 10073].

12. KASSAR, RAYMOND EDWARD (SEC v.), Civil Action No. 83-20267 (N.D. Ca., filed September 26, 1983) [Lit. Rel. No. 10137].

13. LEWIS, JAMES D. (SEC v.), Civil Action No. 2-83-228 (E.D. Tenn., filed August 11, 1983) [Lit. Rel. Nos. 10114 and 10429].

14. MADAN, MANOHAR LAL, et al. (14 defendants), (SEC v.), Civil Action No. 83-5053 (S.D.N.Y., filed July 7, 1983) [Lit. Rel. Nos. 10063, 10991 and 11034].

15. MAURER, JOHN C. (SEC v.), Civil Action No. 83-2412 (D.D.C., filed August 18, 1983) [Lit. Rel. No. 10098].

16. MONTGOMERY, SAM B. (SEC v.), Civil Action No. 82-6728 (S.D.N.Y., filed October 12, 1982) [Lit. Rel. No. 9782].

17. MUSELLA, DOMINICK (15 defendants) (SEC v.), Civil Action No. 83-0342 (S.D.N.Y., filed January 11, 1983) [Lit. Rel. Nos. 9862, 9864, 10169, 10205, 10266, 10328 and 10791].

18. MUTH, PETER (SEC v.), Civil Action No. 82-7317 (S.D.N.Y., filed November 4, 1982) [Lit. Rel. No. 9808].

19. OLZMAN, SAUL, Beatrice Blucher and Everett Wadler (SEC v.), Civil Action No. 83-2489 (D.D.C., filed August 24, 1983) [Lit. Rel. No. 10104].

20. PETROU, PIERRE J. (SEC v.), Civil Action No. 82-3413 (D.D.C., filed December 2, 1982) [Lit. Rel. No. 9828].

21. PLATT, GEORGE, et al. (13 defendants), (SEC v.), Civil Action No. 83-225R (W.D. Okla., filed February 1, 1983) [Lit. Rel. No. 9886].

22. SMITH, WILLIAM P., Paul E. Hurley and Richard P. Garvey (SEC v.), Civil Action No. 83-733 (D.C. Mass., filed March 18, 1983) [Lit. Rel. No. 9933].

23. WADLER, EVERETT J. (In the Matter of), Exchange Act Release No. 20109 (August 24, 1983).

24. WATTENBARGER, EDWIN T. and Phillip C. Yarbrough (SEC v.), Civil Action No. 83-2867 (D.D.C., filed September 29, 1983) [Lit. Rel. No. 10143].

3/17/87

Securities and Exchange Commission
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1983 - September 30, 1984

1. BRANT, PETER N., Kenneth P. Felis, R. Foster Winans, Jr., David W.C. Clark, and David J. Carpenter (SEC v.), Civil Action No. 84-3470 (S.D.N.Y., filed May 17, 1984) [Lit. Rel. Nos. 10386, 10454, 10841 and 10908]

2. BRANT, PETER N. (In the Matter of), Exchange Act Release No. 21136 (July 12, 1984).

3. BRETT, THOMAS F., SR. (SEC v.), Civil Action No. 84-1539 (E.D. Pa., filed March 30, 1984) [Lit. Rel. No. 10340].

4. COURTOIS, E. JACQUES, JR. (SEC v.), Civil Action No. 84-0593 (S.D.N.Y., filed February 6, 1984 [Lit. Rel. No. 10283].

5. COURTOIS, E. JACQUES, JR. (In the Matter of), Exchange Act Release No. 20830 (April 6, 1984).

6. COVELLO, JAMES L. (In the Matter of), Exchange Act Release No. 20826 (April 5, 1984).

7. DREILING, TERRENCE E. (SEC v.), Civil Action No. 84-1904 (D. Colo., filed September 25, 1984) [Lit. Rel. No. 10563].

8. KARANZALIS, STEPHEN G., Aaron L. Lerman, Alfred T. Salvatore, Jr., Steven Crow, Kenneth Petricig, Stephen L. Wallis, and Sharon Willey (SEC v.), Civil Action No. 84-2070 (S.D.N.Y., filed June 28, 1984) [Lit. Rel. Nos. 10459 and 10471].

9. PETERSON, WILLIAM E. and David Spiker (In the Matter of), Exchange Act Release No. 21113 (July 2, 1984).

10. SPIKER, DAVID, William Peterson, and Norm Brock (SEC v.), Civil Action No. 84-429 (W.D. Wa., filed June 18, 1984) [Lit. Rel. No. 10444].

11. STEIN, MARTIN E., SR. (SEC v.), Civil Action No. 84-730 (M.D. Fla., filed August 3, 1984) [Lit. Rel. No. 10479].

12. TENNEY, JOHN B. and Laurence M. Gibney (SEC v.), Civil Action No. 84-829 (D.C. Oregon, filed August 7, 1984) [Lit. Rel. Nos. 10486 and 10629].

13. MAYER, W. PAUL, Billy Bob Harris, Sandra K. Ryno, Gayle L. Schroder, Malcolm B. Davis, Doyle L. Sharp, Julie Williams, Julia D. Booker, and William Mathis (SEC v.), Civil Action No. 84-0066 (S.D.N.Y., filed January 5, 1984) [Lit. Rel. Nos. 10251 and 10746].

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	LBO
		Hanna Mining Co.	4/6/82, Acquisition bid by Norcen Energy Resources Ltd.	x		
		Peavey Co.	4/19/82, merger talks with Con Agra Inc.		x	
		Allied Maintenance Corp.	6/18/82, Merger talks		x	
		Sta-Rite Industries, Inc.	5/24/82, Firm for sale		x	
		Olympia Brewing Co.	6/2/82, Tender Offer by Pabst Brewing Co.		x	
		Thiokol Corp.	7/19/82, Morton-Norwich Products to buy		x	
		Criton Corp.	8/24/82, Tender Offer by Dyson-Kissner-Moran Corp.		x	
		Bendix Corp.	9/8/82, United Technologies launches bid	x		
		Itek Corp.	1/17/83, Tender offer by Litton Industries		x	
		Instrumentation Laboratory Inc.	1/31/83, Tender offer by Allied Corp.		x	

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	LBO
		Sierra Research Corp.	4/20/83, Merger offer by LTV Corp.		x	
		Maryland Cup Corp.	6/28/83 Merfer offer by Ft. Howard Paper		x	
		Simmonds Precision Products Inc.	6/29/83, Hercules Inc. to acquire		x	
		Alexander & Alexander Services Inc.	7/14/83, Sedgwick Group may acquire		x (but talks collapsed)	
		HMW Industries Inc.	8/17/83, Tender offer by Clabir Corp.	x		
		RCA Corp.	9/23/83, Hertz Corp. subsidiary sold, 9/26/83, CIT Financial to be sold		x	
		Cone Mills Corp.	11/29/83, Merger offer by Western Pacific Industries, Inc.	x		
		Esquire Inc.	12/5/83 Merger offer by Gulf & Western		x	
		Jewel Companies Inc.	6/8/84, Tender offer by American Stores Co.	x		
		Carter Hawley Hale Stores, Inc.	4/2/84, Tender offer by The Limited, Inc.	x		
		Electronic Data Systems Corp.	5/17/84, Talks re sale of company		x	

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	or * other LBO/
		A.C. Nielsen Co.	5/18/84, Merger offer by Dun & Bradstreet Corp.		x	
		Esmark Inc.	5/22/84, Tender offer by Beatrice Foods		x	
		Continental Group Inc.	6/5/84, Merger offer by Diamond Land Corp.	x		
		Crocker National Corp.	7/12/84, Majority stake to be sold to Midland Bank		x	
		SFN Companies, Inc.	8/23/84, E.M. Warburg, Pincus & Co., to acquire		x	
		ARA Services, Inc.	9/12/84, Leveraged buy-out proposal by management			x
		G.D. Searle & Co.	9/28/84, Searle Family to sell stake		x	*
		Textron, Inc.	10/25/84, Bid by Chicago Pacific Corp.	x	x	
				1st hostile then friendly		
		Holiday Corporation	1/7/85, Self tender offer by Holiday Corp.		N/A	

INSIDE TRADER	EMPLOYER	STOCK	TRANSACTION	HOSTILE	FRIENDLY	* other LBO/
	Drexel Burnham Lambert Inc.	American Natural Resource Co.	3/1/85 Cash Tender Offer offer by Coastal Corp.	x		
		Sperry Corp.	3/1/85, Talks end with ITT Corp.		x	
		McGraw Edison Co.	3/22/85, Leveraged buy-out			x
		Crown Zellerbach Corp.	4/28/85, Sir James Goldsmith offer to acquire	x		
		Multimedia, Inc.	4/5/85, Leveraged buy-out proposals			x
		Houston Natural Gas	5/2/85, Merger offer by Internorth, Inc.		x	
		Nabisco Brands Inc.	5/30/85, merger talks with R. J. Reynolds, Inc.		x	
		Union Carbide Corp.	12/9/85, Bid by GAF Corp.	x		
		Midcon Corp.	12/10/85, Midcon Corp. raises dividend			*
Ilan K. Reich	Wachtell, Lipton, Rosen & Katz	SFN Companies, Inc.	8/23/84, E.M. Warburg, Pincus & Co. to acquire		x	
		G.D. Searle & Co.	9/28/84 Searle family to sell stake			*
Marcel Katz	Lazard Freres & Co.	RCA	12/11/85 announcement GE would acquire RCA		x	

12/5/86

Securities and Exchange Commission
Division of Enforcement

Insider Trading Cases
October 1 1984 - September 30, 1985

1. WILLIAMS, PAUL J. (In the Matter of), Exchange Act Release No. 22450 (September 24, 1985).

2. NEWMAN, JAMES MITCHELL (In the Matter of), Exchange Act Release Nos. 22488 (September 19, 1985) and 23372 (June 25, 1986).

3. ANTONIU, ADRIAN (In the Matter of), Exchange Act Release No. 22487 (September 19, 1985).

4. BRAUNINGER, EARL W., et al. (2 defendants) (SEC v.), Civil Action No. C85-2626Y (N.D. Ohio, filed September 12, 1985) [Lit. Rel. No. 10868].

5. NUGENT, JOHN M., JR., et al. (2 defendants) (SEC v.), Civil Action No. 85-2783 (D.D.C., filed August 29, 1985) [Lit. Rel. No. 10858].

6. FELIS, KENNETH P. (In the Matter of), Exchange Act Release No. 22289 (August 5, 1985).

7. ORME, NATHANIEL L. (SEC v.), Civil Action No. 85-1993 (D.D.C., filed June 21, 1985) [Lit. Rel. No. 10799].

8. STIVALETTI, JAMES (In the Matter of), Exchange Act Release No. 22156 (June 18, 1985).

9. SHARP, RICHARD L. (SEC v.), Civil Action No. 85-0553 (E.D. Va., filed June 12, 1985) [Lit. Rel. Nos. 10781 and 11062].

10. HOSS, GEORGE W., et al. (2 defendants) (SEC v.), Civil Action No. 85-3633-R (C.D. Calif., filed May 31, 1985) [Lit. Rel. Nos. 10789 and 10932].

11. SARZYNSKI, MARYANN, et al. (8 defendants) (SEC v.), Civil Action No. 85-3864 (S.D.N.Y., filed May 22, 1985) [Lit. Rel. No. 10763].

12. KARANZALIS, STEPHEN G. (In the Matter of), Exchange Act Release No. 22054 (May 20, 1985).

13. GAFFNEY, JOSEPH, et al. (3 defendants) (SEC v.), Civil Action No. 85-2967 (S.D.N.Y., filed April 18, 1985) [Lit. Rel. No. 10725].

14. TATUSKO, STEVEN R. (In the Matter of), Exchange Act Release No. 21849 (March 13, 1985).

15. STUART, WILLIAM D., SR. (In the Matter of), Exchange Act Release No. 21671 (January 18, 1985).

16. STUART, WILLIAM D., JR., et al. (3 defendants) (SEC v.), Civil Action No. 3-85-0117G (N.D. Texas, filed January 17, 1985) [Lit. Rel. No. 10655].

17. MORGAN, KENNETH D. (SEC v.), Civil Action No. 84-8895 (S.D.N.Y., filed December 12, 1984) [Lit. Rel. No. 10630].

18. HUFF, JAMES D. (SEC v.), Civil Action No. 84-3709 (D.D.C., filed December 6, 1984) [Lit. Rel. No. 10624].

19. ABLAN, FEDERICO, et al. (4 defendants) (SEC v.), Civil Action No. 84-8532 (S.D.N.Y., filed November 27, 1984) [Lit. Rel. Nos. 10618 and 10830].

20. FOX, JOSEPH, et al. (4 defendants) (SEC v.), Civil Action No. 5-84-172 (N.D. Texas, filed October 1, 1984) [Lit. Rel. No. 10548].

12/5/86

Securities and Exchange Commission
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1985 - September 30, 1986

TOTAL: 34

1. HARTNETT, THOMAS M. (SEC v.), Civil Action No. 86-6894 (S.D.N.Y., filed Sept. 8, 1986) [Lit. Rel. No. 11210].

2. FRANCO, ANTHONY M. (SEC v.), Civil Action No. 86-2382 (D.D.C., filed Aug. 26, 1986) [Lit. Rel. No. 11206].

3. WAHL, ROBERT A. (SEC v.), Civil Action No. 86-0568 (D. Neb., filed Aug. 20, 1986) [Lit. Rel. No. 11203].

4. KATZ, HARVEY, et al. (4 defendants) (SEC v.), Civil Action No. 86-8088, filed Aug. 7, 1986) [Lit. Rel. No. 11185].

5. KATZ, MARCEL (In the Matter of), Securities Exchange Act Release No. 23520 (Aug. 7, 1986).

6. AIZEN, FRED (In the Matter of), Securities Exchange Act Release No. 23519 (Aug. 7, 1986).

7. WILLIAM WEKSEL, et al. (2 defendants) (SEC v.), Civil Action No. 86-6063-CSH (S.D.N.Y., filed Aug. 6, 1986), [Lit. Rel. No. 11183].

8. LEWIS, MARTIN M., et al. (3 defendants) (SEC v.), Civil Action No. 86-2116 (D.D.C., filed Aug. 4, 1986) [Lit. Rel. No. 11180].

9. HENDERSON, DAVID J., et al. (2 defendants) (SEC v.), Civil Action No. 86-2002-N (D. Mass., filed July 7, 1986) [Lit. Rel. No. 11149].

10. WILKIS, ROBERT M., et al. (3 defendants) (SEC v.), Civil Action No. 86-5182 (S.D.N.Y., filed July 1, 1986) [Lit. Rel. No. 11145].

11. WILKIS, ROBERT M. (In the Matter of), Securities Exchange Act Release No. 23385 (July 1, 1986).

12. SOKOLOW, IRA B. (SEC v.), Civil Action No. 86-5183 (S.D.N.Y., filed July 1, 1986) [Lit. Rel. No. 11146].

13. SOKOLOW, IRA B. (In the Matter of), Securities Exchange Act Release No. 23386 (July 1, 1986).

14. BASTIEN, RICHARD J. (SEC v.), Civil Action No. 86-1774 (D.D.C., filed June 25, 1986) [Lit. Rel. No. 11136].

15. LEVINE, DENNIS B. (In the Matter of), Securities Exchange Act Release No. 23300 (June 5, 1986).

16. HARRIS, BILLY BOB (In the Matter of), Securities Exchange Act Release No. 23243 (May 15, 1986).

17. NEWTON, JOHN S. (SEC v.), Civil Action No. 86-0553-A (E.D. Va., filed May 14, 1986) [Lit. Rel. No. 11101].

18. LEVINE, DENNIS, et al. (4 defendants) (SEC v.), Civil Action No. 86-3726 (S.D.N.Y., filed May 12, 1986) [Lit. Rel. Nos. 11095, 11117 and 11144].

19. THE FIRST BOSTON CORPORATION (SEC v.), Civil Action No. 86-3524 (S.D.N.Y., filed May 5, 1986) [Lit. Rel. No. 11092].

20. WALKER, RONALD R., et al. (7 defendants) (SEC v.), Civil Action No. 86-0523-CV-W-6 (W.D. Mo., filed Apr. 22, 1986) [Lit. Rel. No. 11071].

21. EVANS, ANDREW L. (SEC v.), Civil Action No. C86-502 (W.D. Wa., filed Apr. 22, 1986) [Lit. Rel. Nos. 11076 and 11084].

22. THOMAS, HARRY EDWARD, et al. (5 defendants) (SEC v.), Civil Action No. 86-C-0313G (D.C. Utah, filed Apr. 14, 1986) [Lit. Rel. No. 11138].

23. HIGGINS, CARLYLE W., et al. (5 defendants) (SEC v.), Civil Action No. 86-8204 (S.D. Fla., filed Apr. 14, 1986) [Lit. Rel. No. 11056].

24. RUMMONDS, FRANK M. (SEC v.), Civil Action No. 86-0337 (E.D. Cal., filed Mar. 24, 1986) [Lit. Rel. No. 11033].

25. MORRIS, JACK R., et al. (3 defendants) (SEC v.), Civil Action No. C-86-201-R (M.D. N.C., filed Mar. 10, 1986) [Lit. Rel. No. 11050].

26. PATTY, DOUGLAS E., et al. (5 defendants) (SEC v.), Civil Action No. 86-1498 (C.D. Cal., filed Mar. 10, 1986) [Lit. Rel. No. 11022].

27. MOORE, MORGAN F. (SEC v.), Civil Action No. N-86-88-PCD (D. Conn., filed Mar. 3, 1986) [Lit. Rel. No. 11013].

28. BORER, JOHN J., JR. (SEC v.), Civil Action No. 86-1204 (C.D. Cal., filed Feb. 25, 1986) [Lit. Rel. No. 11009].

29. OFFER, CHARLES S. (SEC v.), Civil Action No. 86-0584 (D.D.C., filed Feb. 24, 1986) [Lit. Rel. No. 11008].

30. CREMONESE, JOSEPH G. (SEC v.), Civil Action No. 86-0553 (S.D.N.Y., filed Jan. 17, 1986) [Lit. Rel. No. 10984].

31. HENGEN, RONALD, et al. (5 defendants) (SEC v.), Civil Action No. 86-0306 (S.D.N.Y., filed Jan. 9, 1986) [Lit. Rel. Nos. 10981, 11113 and 11153].

32. APRAHAMIAN, RONALD V., et al. (4 defendants) (SEC v.), Civil Action No. 85-3996 (D.D.C., filed Dec. 19, 1985) [Lit. Rel. No. 10961].

33. MOOREHEAD, DWIGHT C. (SEC v.), Civil Action No. 85-2555 (D. Colo., filed Dec. 5, 1985) [Lit. Rel. No. 10948].

34. BAILEY, EMERA, et al. (7 defendants) (SEC v.), Civil Action No. 85-3145 (D.D.C., filed Oct. 2, 1985) [Lit. Rel. No. 10896].

4/17/87

Securities and Exchange Commissio
Division of Enforcement

Enforcement Actions Involving Insider Trading Violations
October 1, 1986 - April 17, 1987

Total: 22

1. BULL, HENDRIX R. (SEC v.), Civil Action No. 87-2176 (S.D. Cal., commenced Apr. 7, 1987) [Lit. Rel. No. _____].

2. VASKEVITCH, NAHUM (4 defendants) (SEC v.), Civil Action No. 87-1620 (S.D.N.Y., commenced Mar. 11, 1987) [Lit. Rel. Nos. 11365, 11365A and 11386].

3. GROSSMAN, ISRAEL, et al. (7 defendants) (SEC v.), Civil Action No. 87-1031 (S.D.N.Y., commenced Feb. 17, 1987) [Lit. Rel. No. 11359].

4. SIEGEL, MARTIN A. (SEC v.), Civil Action No. 87-0963 (S.D.N.Y., commenced Feb. 13, 1987) [Lit. Rel. No. 11354].

5. SIEGEL, MARTIN A. (In the Matter of), Securities Exchange Act Release No. 24098 (Feb. 13, 1987).

6. ELECTRO-CATHETER CORP., et al. (3 defendants) (SEC v.), Civil Action No. 87-0267 (D.D.C., commenced Feb. 4, 1987) [Lit. Rel. No. 11347].

7. SALSBURY, ROBERT (In the Matter of), Securities Exchange Act Release No. 24019 (Jan. 21, 1987).

8. SALSBURY, ROBERT (SEC v.), Civil Action No. 87-0097 (S.D.N.Y., commenced Jan. 7, 1987) [Lit. Rel. No. _____].

9. ELLIOTT, ALFRED (SEC v.), Civil Action No. 86C10184 (N.D. Ill., commenced Dec. 30, 1986) [Lit. Rel. No. 11335].

10. DePALMA, ANTHONY A. (SEC v.), Civil Action No. 86-3541 (D.D.C., commenced Dec. 30, 1986) [Lit. Rel. No. 11333].

11. AKSLER, SAMUEL M., et al. (9 defendants) (SEC v.), Civil Action No. 86-9811 (S.D.N.Y., commenced Dec. 23, 1986) [Lit. Rel. No. 11325].

12. CECOLA, RANDALL D. (SEC v.), Civil Action No. 86-9735 (S.D.N.Y., commenced Dec. 22, 1986) [Lit. Rel. No. 11313].

13. CECOLA, RANDALL D. (In the Matter of), Securities Exchange Act Release No. 23919 (Dec. 22, 1986).

14. POMERANTZ, MELVIN N. (SEC v.), Civil Action No. 86-9499 (S.D.N.Y., commenced Dec. 11, 1986) [Lit. Rel. No. 11305].

15. DAVID, MICHAEL N. (SEC v.), Civil Action No. 86-9462 (S.D.N.Y., commenced Dec. 10, 1986) [Lit. Rel. No. 11334].

16. BOESKY, IVAN F. (SEC v.), Civil Action No. 86-8767 (S.D.N.Y., commenced Nov. 14, 1986) [Lit. Rel. No. 11288].

17. BOESKY, IVAN F. (In the Matter of), Securities Exchange Act Release No. 23802 (Nov. 14, 1986).

18. KOPFMANN, ALFRED E., II, et al. (2 defendants) (SEC v.), Civil Action No. 86-6114 (N.D. Cal., commenced Oct. 28, 1986) [Lit. Rel. No. 11276].

19. REICH, ILAN K. (SEC v.), Civil Action No. 86-7775 (S.D.N.Y., commenced Oct. 9, 1986) [Lit. Rel. No. 11246].

20. BROWN, DAVID S. (SEC v.), Civil Action No. 86-7774 (S.D.N.Y., commenced Oct. 9, 1986) [Lit. Rel. No. 11245.

21. BROWN, DAVID S. (In the Matter of), Securities Exchange Act Release No. 23698 (Oct. 9, 1986).

22. FLAHERTY, JAMES F., JR. (SEC v.), Civil Action No. 86-2896-Y (D. Mass., commenced Oct. 8, 1986) [Lit. Rel. Nos. 11254 and 11298].

Mr. GIULIANI. It is a list of all the criminal insider trading cases that had been brought in the history of the Southern District of New York, which——

Senator DIXON. Is that available to all of us, Mr. Chairman?

The CHAIRMAN. It will be made available. He is going to put it in the record.

Senator DIXON. I thank the chairman.

Mr. GIULIANI. That chart, prior to the time Dennis Levine was arrested, prior to May 1986, reveals the following 2 statistical comparisons. Before 1984, there had been 12 criminal prosecutions for insider trading in the history of the United States.

The CHAIRMAN. How many?

Mr. GIULIANI. Twelve, before 1984. So in the almost 50 years that the insider trading laws were on the books, we had prosecuted 12 people criminally in the United States for insider trading, some of whom went to prison, most of whom did not.

Since 1984, and up until the time of the Dennis Levine case, before the Levine, Boesky, that whole group of cases, we had prosecuted approximately 40 people in a 2 year period. So that in a 2 year period three to four times as many people had been prosecuted for insider trading than had ever been the case in our history before that date.

Since Levine, Boesky, Siegel and Jefferies, who were the primary individuals who have either pleaded guilty or agreed to plead guilty, there have been 10 more convictions in that area.

If you look at the chart and you go through the list of people that have been convicted, not the people accused, concerning whom there will be trials, and at this point, we have to presume that they are innocent, but the people that have been found guilty, either by a jury or by a plea of guilty, you will see numerous investment banking firms, numerous large law firms, accounting firms and other major institutions, in which individuals at a middle level, high level, various levels, were engaged in the crime of insider trading.

In most cases, and the chart doesn't show this really adequately, because it's listed by individual names, in most cases, these people were involved not in individual acts of getting a piece of information, realizing they could make $100,000 or $200,000 and doing it once, but, in fact, most of these people were involved in a pattern or in a conspiracy with others that was well-planned, well-thought-out and carried on for a substantial period of time.

GREED WAS NOT THE ONLY MOTIVE

The reasons that I believe they did it are important, because they are important to the things that we have to do to change that. Obviously, they did it for greed, because there was a great deal of money involved and that could be earned from doing it. Some of them did it, not just for greed for money but in order to enhance their position within the firms in which they worked, because in some cases, they didn't personally profit in the sense of actually making an individual profit on the deal. The way they profited was being considered to be expert in what they were doing, and therefore, their salary or the commissions that they received or their

standing in the firm and the industry was increased by the fact that they had made an ingenious investment that benefited the firm.

I believe that in almost all of these cases, and in some of the earlier ones, in the investigations and even during portions of the investigations where people were being tape recorded, one of the things that you see is that almost all of these people engaged in analysis of the profits to be made, the things to be gained against the consequences, if they were caught.

In other words, they calculated, what can we gain for this, either for ourselves or for our firms against the chance that we will be caught, and then the consequences to us, if we will be caught. And if we can raise, substantially, the risk of being caught and the consequences for engaging in this kind of conduct, this is precisely the kind of criminal conduct that we can deter, unlike some forms of violent crime, some forms of crimes of passion, where incarceration is obviously necessary to protect the public, but because the crime is either an unconscious crime or a crime that is not necessarily a crime of deliberation, the general deterrent effect isn't as great. This is the kind of crime where you can deter the crime and the commission of the crime by raising the risk of being caught and the consequences of being caught. And I think that is precisely what the FTC and the U.S. attorney's offices have been engaged in.

And if you look at that statistic, only 12 criminal prosecutions before January or June 1984, certainly, the message was being sent to people who were making that calculation that there was a very small risk of being caught. Only 12 had ever been caught in 50 years. And there was a very small chance that even if you did get caught, that you would serve any time in prison. Now many things have to be done to deal with this problem, and I don't think any one person has all of the answers or even most of the answers to what has to be done to turn this problem around. So what I would prefer to do is just list a few suggestions, things to think about and talk about, which certainly are not an exclusive list of all the things that have to be considered and have to be done, and I would like to throw them out in the way of suggestions.

VIGOROUS ENFORCEMENT BY SEC

The first thing I think that obviously has to be done is the vigorous enforcement activity of the SEC has to continue to increase. There is no doubt that the problem of insider trading and related abuses of the securities laws, which go beyond insider trading, is a more substantial problem than we realized 2, 3 and 4 years ago. Whatever the level of it, however extensive it is, it is certainly beyond anything we believed was the case 2 or 3 years ago. Therefore, the resources of the SEC have to be expanded to deal with what we now realize is a much larger problem than the SEC was dealing with 2 and 3 years ago. I think increasing the enforcement side of the SEC is the single most important thing that can be done to turn this problem around.

Obviously, there are many cases, they are big cases, they have to be focused on, and they have to be done well, and if they are done well and done effectively, then they are going to send a deterrent

message that begins to reduce this kind of activity and begins to rebuild public confidence in the marketplace.

CRIMINAL PROSECUTIONS SHOULD INCREASE

Along with that, obviously, the number of criminal prosecutions has to also increase, so consideration has to be given to expanding the resources of the Department of Justice to deal with the problem of insider trading, security fraud, and white collar crime. I know my office best, and in my office, there is a competition between and among all of the priorities that you deal with—organized crime, drug prosecutions, other forms of white collar crime that are substantial problems, like tax evasion, fraud outside of the securities market, public corruption. All of those things are equally as important as the problem of fraud in the securities market. They all compete for resources. They all compete for attention. They all compete for assistant U.S. attorneys being assigned to do things.

And there is no doubt that from the point of view of the Department of Justice, the problem of insider trading, the problem of securities fraud is, for us, a much bigger problem than we realized 2 years ago or 3 years ago, before the series of cases that I mentioned before began to emerge. So I think serious consideration has to be given to expanding the resources that are available at the prosecution level for these cases.

The SEC does——

Senator RIEGLE [presiding]. Why don't I just stop you at that point, just to ask one question, so we don't lose it, and that is, if you were to take the resources of your own office and your own personal time, say over the last year, can you give me an estimate of the percentage of time and resources that have gone on into this problem versus this other set of problems that you have described?

Mr. GIULIANI. A very rough estimate, Senator, would be, maybe 10 percent, maybe 5 to 10 percent, in that range.

Senator RIEGLE. Thank you.

Mr. GIULIANI. I think it is also timely to take a look at the penalties under the criminal provisions of 10(b)(5) and the mail and wire fraud statutes, which have the same maximum penalty of 5 years and are commonly used in prosecutions of insider trading cases. The maximum penalty is now 5 years. That maximum penalty probably made sense, given what we knew when those statutes were passed about the level and the extent of insider trading and fraud.

In light of the cases that have been completed that involve multimillion and sometimes billion dollar frauds, the 5-year penalty, in certain cases, is probably inadequate. And therefore, the scope of punishment should be increased

I think that is something that the committee should consider. There would be another benefit to increasing the maximum penalty. That doesn't mean that in cases of minor fraud or intermediate fraud that penalty has to be given. A judge would have discretion to give 1 year or 2 years, but he should also have the discretion to give 8, 9 or 10 years, if, in fact, we are talking about a multimillion dollar or multibillion dollar fraud that involves a pattern of fraud.

In addition to dealing with the individual case, I think that would send a very important signal, which Senator D'Amato mentioned before, to the judiciary, and that is that it is the sense of the U.S. Congress that prison sentences should by and large be given in these cases as a general rule. Obviously, you have to leave some discretion to a judge in those cases where there are truly extenuating circumstances and someone should not receive a prison sentence, but I think it would be helpful to send, as a general message, the notion that it is the sense of Congress that in these cases where deliberate fraud is involved, and where we can get a general deterrent effect from a prison sentence, that a judge should impose prison sentences in wire fraud, mail fraud and insider trading cases.

The level and the extent of the sentence, obviously, has to be up to the judge. We can't assess all of the individual factors in a particular case.

I think if you look at this chart that we have submitted, you will also see that although the sentences are not precisely the sentences that I would like to see or that I think many would like to see, the trend has been in that direction. In the early cases, almost no prison sentences were given. As the cases increased, prison sentences of a few months and then a few years started to be given. And now we have gotten prison sentences of 3 and 4 years.

So I think many judges are beginning to realize what we are talking about here today, that this was not an isolated problem which they may have believed 2 and 3 years ago, but it is a more extenstive problem and that in sentencing people, you have to take into consideration the extent of the problem.

MANDATORY MINIMUM PENALTY

In the areas of sentencing and things for the committee to consider, you might also consider an additional penalty, a mandatory minimum penalty to be imposed on people who commit crimes against the system. By that I mean people who engage in perjury and obstruction of justice. In at least, I believe, half of these cases, those people convicted of insider trading have also been convicted of committing other crimes including perjury or obstruction of justice or a crime related to obstructing the SEC, in particular, sometimes other agencies, in their investigation, in their civil or criminal investigation of their wrongdoing.

That is not just an isolated problem. That is a problem that extends beyond just 1 or 2 cases. And in fact, many people believe that there's really no penalty, no additional penalty that they are going to receive, if they lie about their being involved in securities fraud or insider trading, when they are questioned under oath by the SEC or by investigators from the postal authorities or the FBI.

Something that could be very useful to consider would be a mandatory minimum additional penalty of 1 or 2 years for those who are proven beyond a reasonable doubt to have been engaged in perjury or obstructing an investigation.

The major reforms that are going to come, hopefully, are going to come in the area of self-regulation. And there, I think, to just briefly list a number of things that should be considered. The firms in

the financial community have to consider devoting a much more substantial portion of their resources to compliance, to dealing with educating their employees as to the requirements of the law, and not just educating them, but auditing and investigating to determine whether, in fact, those restrictions are being adhered to by the firm. Those things are best done internally. The best role that the Congress could perform is to see whether or not, in fact, there is a good faith effort on the part of firms to voluntarily self-regulate.

I believe that there are firms that are attempting to do that, that are attempting to make some dramatic changes in the way they have done things, because they recognize this problem. I think that is something that should first be left to self-regulation. If that doesn't work, then I think it is appropriate for the Congress to have to regulate for them, if they don't show the ability to increase emphasis on compliance, to increase emphasis on internal auditing and investigating to determine whether or not their employees are taking the laws against insider trading seriously enough.

The whole question of the Chinese wall and the arbitrage function being conducted within an investment banking firm raises a question as to whether a conflict of interest exists. Where an arbitrageur is speculating in takeovers, and an investment banker in the same firm is involved in the development of a takeover strategy, offensive or defensive, a determination as to whether or not those two functions can exist within the same firm must be made. It must also be decided whether the Chinese wall approach that has been used in the past is effective or not. I think that is an area that Congress should certainly take a look at. I am not saying that legislation is necessarily needed, but if, in fact, they don't do things to dramatically improve the way in which that separation occurs within firms, that may be another area where Congress should consider legislating.

DEFINING INSIDER TRADING

Just to conclude—and these are things that are best left for question and answer—I think at this point it probably would be effective to have a congressional definition of insider trading. A lot of the issues that are raised are frivolous issues, but they keep getting raised, and I think they distract the public from the core violations of insider tradings that are clear out-and-out fraud. If there was a clear, precise definition of it, enacted by Congress, it could help to end a lot of the irrelevant debate about whether insider trading, or what forms of insider trading actually constitute crimes.

And I think the things that the chairman has talked about, including reducing the 13(d) period of time from 10 days, I believe, to 5 or 3, to look at the margin requirements, and then to look at this whole issue that John Fallon, the chairman of the New York Stock Exchange has raised as to the pooling arrangements that are made in takeover deals where, in fact, some of the people who participate in the arrangements are people or institutions that appear to have at least economic conflicts of interest with others in the deal, is something that people from the industry could certainly enlighten you on more than I believe I could, but it is something that I think

should be on your agenda for taking a look at and seeing whether legislation is necessary.

In the long run, however, there is one overall issue that doesn't relate to specific securities legislation but certainly has a great deal to do with all of this.

The other day I was at NYU Business School, and the dean of the school said to me that when he read about the cases that have now been described as the Yuppie cases, which also occurred in May of last year, it was the most disheartening group of cases in the business area that he had ever read about in his career. These young men, were all less than 30 years old. They had graduated from either business school or law school within 2 years of the date on which they were convicted. They had graduated from some of the best institutions that our society has available for training people for business and for the law. And within 2 years of their graduation from those institutions, they were engaged in a massive pattern of illegal behavior, now proven, not just alleged.

That Yuppie case says something about the way we educate young people as to values in this country and as to ethics. We must take a renewed look at the teaching of values from the early grades through high school, colleges, graduate schools, law schools. The whole subject of ethics and values in education and in our society is something that we have to emphasize as a society.

Thank you, Mr. Chairman.

Senator RIEGLE. Thank you very much.

Mr. Lynch, let us hear from you now.

STATEMENT OF GARY LYNCH, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, DC

Mr. LYNCH. Thank you, Senator Riegle.

I appreciate the opportunity to testify before this committee. The views that I will express today are my own and do not necessarily reflect the views of the Commission or of any of my colleagues on the staff of the Commission.

The Commission's enforcement program addresses a broad range of Federal securities violations. In 1986, the Commission brought 312 enforcement actions, including cases involving insider trading, market manipulation, fraudulent securities offerings, violations by broker-dealers, investment companies, and investment advisers, and issuer financial statement reporting violations.

MAGNITUDE AND GRAVITY OF CASES

Although cases involving insider trading are only one component of the Commission's comprehensive enforcement program, the magnitude and gravity of the cases recently brought by the Commission and the criminal prosecutions initiated by Mr. Giuliani's office, demonstrate that insider trading and other related problems present the most serious enforcement challenge currently facing the Commission.

During fiscal year 1986 the Commission obtained court orders in 34 insider trading cases requiring the payment of approximately $30 million in disgorgement and $3.7 million in civil penalties. Al-

though these were record numbers, the numbers for 1986, the Commission has already brought 22 insider trading cases during the current fiscal year beginning October 1, 1986, and it has obtained court orders requiring defendants to pay more than $55 million as disgorgement and approximately $51 million in civil penalties.

The Commission is also litigating cases at the current time in which it alleges the defendants have obtained at least $6 million in illegal profits from insider trading.

Insider trading is a difficult crime to detect, and it is even more difficult to prosecute. Unlike an investigation of a crime such as bank robbery, where enforcement authorities generally know at the outset that an illegal act has been committed, an insider trading investigation is seldom based, in its initial stages on concrete evidence that a violation has occurred. Instead, insider trading investigations typically are commenced to examine suspicious trades or trading patterns that may indicate a violation of the law, but may also reflect legitimate trading.

Moreover, unlike some types of law enforcement surveillance, such as radar to detect speeding by automobiles or the monitoring of national borders to intercept contraband, surveillance of the security markets cannot uncover direct evidence of insider trading violations. Market surveillance simply reveals suspicious trades and trading patterns which must then be fully investigated to determine whether violations have actually occurred.

The Commission often encounters difficulties when investigating suspicious trades that have been identified through surveillance activities.

Persons who have engaged in insider trading violations seldom confess to the violations. In fact, individuals who are involved in an insider trading conspiracy often go to great lengths to avoid creating evidence that might lead to their detection. And some of these people who are involved in the investigations are not averse to lying or creating fictitious documentation if a Commission investigation focuses on their conduct. Indeed, as Mr. Giuliani pointed out, many insider trading investigations also lead to criminal charges of perjury and obstruction of justice.

INSIDER TRADING AND FOREIGN COUNTRIES

When insider trading originates from a foreign country, detection and prosecution are even more difficult. The Commission's investigative subpoena power is generally limited to persons and entities within the United States, and even when foreign persons or firms are effectively served with a subpoena, foreign secrecy or blocking laws may prohibit the disclosure of the requested information. Thus, the Commission generally knows only that one or more foreign institutions has purchased the particular security prior to a material news announcement by a company. The Commission does not know and often is not able to readily determine the identity of the person or the persons who have placed the order in the first instance. Without such information, the Commission has no indication, other than the timing of the trade, that the transaction may have been violative of the law.

Despite all these difficulties, the Commission's ability to detect and prosecute insider trading has improved dramatically over the past 5 years. There have been significant improvements in the electronic surveillance capabilities of the securities exchanges and the National Association of Securities Dealers. The surveillance systems and transaction audit trails now used by these various organizations permit quick identification of anomalous market activity.

The investigations which led to a number of the recent cases brought by the Commission were prompted by information referred from securities exchanges.

We have also improved our ability to obtain evidence from foreign countries through both bilateral mutual assistance agreements with those countries and less formal arrangements with foreign governments. Using the memorandum of understanding with Switzerland which was signed in 1982, the Commission can now obtain access to Swiss bank records when investigating insider trading cases.

The Commission has also negotiated memoranda of understanding with its counterparts at the United Kingdom Department of Trade and Industry and the Japanese Ministry of Finance, which provide mechanisms for obtaining information related to market surveillance and enforcement of the securities laws.

In addition, we worked with the Department of Justice in negotiating bilateral agreements which specifically delineate enforcement of the securities laws as matters for which assistance will be available. The Canadian and Cayman Island treaties which have recently been negotiated are two examples of such agreements.

Finally, the passage of the Insider Trader Sanctions Act in 1984 has provided the Commission with the ability to obtain civil penalties of up to three times the profit gained or loss avoided in insider trading cases. These penalties, along with criminal prosecutions brought by the Department of Justice and, in particular, Mr. Giuliani's office, have enhanced the deterrent effect of the Commission's enforcement program against insider trading.

We are currently in the midst of one of the most important and intensive series of investigations that the Commission has ever conducted. The conduct which has already been exposed demonstrates that insider trading is an extremely serious problem, and the investigations which we have undertaken have now expanded beyond insider trading to equally serious violations of the securities laws, such as market manipulation and parking transactions.

I expect that these investigations will consume an even greater percentage of the Commission's enforcement resources during the next year as the cooperating witnesses that we now have continue to provide information that lead to more cases. These investigations, along with the cases already brought by the Commission and Mr. Giuliani's office serve notice on persons who contemplate engaging in securities fraud that the probability of detection, as well as the severity of the sanctions, have increased substantially.

That concludes my introductory statement. I ask that my longer statement that I submitted yesterday be included in the record.

I will be happy to respond to any questions the committee has.

[The complete prepared statement of Gary Lynch follows:]

STATEMENT OF GARY LYNCH
DIRECTOR OF THE DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE U.S. SENATE

CONCERNING RECENT DEVELOPMENTS
IN THE COMMISSION'S ENFORCEMENT PROGRAM

April 22, 1987

Chairman Proxmire and Members of the Committee:

I appreciate this opportunity to testify before the Committee concerning the Commission's recent enforcement actions involving allegations of insider trading, market manipulation, and other types of securities law violations. The views that I express in this statement and in response to questions are my own, and do not necessarily reflect the views of the Commission or of any of my colleagues on the staff of the Commission.

The Commission's enforcement program addresses a broad range of federal securities law violations. In 1986, the Commission commenced a total of 312 enforcement actions. This included 88 cases involving fraudulent securities offerings, 61 cases involving violations by broker-dealers, 42 cases involving issuer financial statement reporting violations, 34 cases involving investment companies, investment advisers, or transfer agents, 34 cases involving insider trading, and 14 cases involving market manipulation. 1/

Although cases involving insider trading are only one component of the Commission's comprehensive enforcement program, the magnitude and gravity of the cases recently brought by the Commission and the criminal prosecutions initiated by the U.S. Attorney's Office for the Southern District of New York demonstrate that insider trading and other related problems present the most serious enforcement challenge currently facing the Commission. During fiscal year 1986, the Commission obtained court orders in insider trading cases requiring the payment of approximately $29.6 million in disgorgement and $3.7 million in civil penalties. During the current fiscal year beginning October 1, 1986, the Commission has already brought 22 insider trading cases, and it has obtained court orders requiring defendants to pay more than $55.2

1/ For statistical purposes, the Commission includes each enforcement action in only one program area. The 34 insider trading cases referred to in the text, however, include 4 cases which are classified in other program areas but which also included allegations of insider trading.

material news. However, price rises prior to announcements may reflect legal purchases by prospective bidders, trading by others on the basis of speculation and rumors, and trading based on technical analyses of price and volume movements.

Unlike some types of law enforcement surveillance, such as radar to detect speeding or the monitoring of national borders to intercept contraband, surveillance of the securities markets cannot uncover direct evidence of insider trading violations. Instead, market surveillance simply reveals suspicious trades and trading patterns, which must then be fully investigated to determine whether violations have actually occurred.

The Commission often encounters difficulties in gathering evidence of all the facts and circumstances pertaining to suspicious trades which have been identified through surveillance activities. Persons who have engaged in insider trading violations seldom confess to the violations. Moreover, because the essence of the crime is theft, misappropriation or conversion of information that may be conveyed orally, violators usually can avoid creating documents or other hard evidence of violations. In fact, individuals who are involved in an insider trading conspiracy often go to great lengths to avoid creating evidence that might lead to their detection, and are not averse to lying or creating fictitious documentation if a Commission investigation focuses on their conduct. Indeed, many insider trading investigations also lead to criminal charges of perjury and obstruction of justice.

Given the nature of the crime and the difficulty of obtaining direct evidence, the Commission often must decide whether to proceed solely on circumstantial evidence even after a full investigation.

When insider trading originates from a foreign country, detection and prosecution are even more difficult. The Commission's investigative subpoena power is generally limited to persons and entities within the United States, and even when foreign persons or firms are effectively served, foreign secrecy or blocking laws 4/ may prohibit the disclosure of the requested information. Moreover, in cases involving foreign trading, the Commission generally knows only that one or more foreign institutions has purchased a particular security prior to a

4/ Secrecy laws are confidentiality laws which protect private interests in bank records, such as the identity of a bank customer. They generally may be waived with the express or implied consent of the customer. Blocking laws generally prohibit the disclosure, copying, inspection or removal of documents located in the territory of the enacting state in compliance with the orders of foreign authorities. They cannot be waived by private parties because they protect national rather than private interests.

material announcement. The Commission does not know, and often is not able to readily determine, the identity of the person or persons placing the orders. Without such information, the Commission has no indication other than the timing of the trade that the transaction may involve fraudulent conduct, since the amount of the purchase may not be unusual for a foreign bank or broker.

Despite these difficulties, the Commission's ability to detect, prosecute and deter insider trading has improved dramatically over the past five years. There have been significant improvements in the electronic surveillance capabilities of the securities exchanges and the National Association of Securities Dealers. The surveillance systems and transaction audit trails now used by these organizations permit quick identification of anomalous market activity. The investigations which led to the Elliot, Grossman, and Vaskevitch cases, which are described later in this statement, were prompted by information referred from securities exchanges.

The Commission has also improved its ability to obtain evidence from foreign countries through both bilateral mutual assistance agreements and less formal arrangements with foreign governments. Using the Memorandum of Understanding with Switzerland signed in 1982, the Commission can now obtain access to Swiss bank records when investigating insider trading cases. The Commission has also negotiated Memoranda of Understanding with its counterparts at the United Kingdom Department of Trade and Industry and the Japanese Ministry of Finance which provide mechanisms for obtaining information related to market surveillance and enforcement of the securities laws. In addition, the Commission has worked with the Department of Justice in negotiating bilateral agreements which specifically delineate enforcement of the securities laws as matters for which assistance would be available. The Canadian and Cayman Islands treaties are two of the most recent examples of such agreements.

Finally, the passage of the Insider Trading Sanctions Act (ITSA) in 1984 has provided the Commission with the ability to obtain civil penalties of up to three times the profit gained or loss avoided in insider trading cases. These penalties, along with criminal prosecutions brought by the Department of Justice and, in particular, the U.S. Attorney's Office for the Southern District of New York, have enhanced the deterrent effect of the Commission's enforcement program against insider trading.

The cases described in this statement, all of which involved securities industry professionals or attorneys in prestigious law firms, demonstrate that insider trading is a very serious problem. The problem has occupied an ever increasing percentage of the Commission's enforcement resources during the past year, and will likely consume an even greater percentage of those resources in the

next year, as cooperating witnesses continue to provide information that leads to more cases.

Recent Cases

The following is a brief description of some of the most important insider trading cases brought by the Commission in the past year. Two additional cases, SEC v. Jafferies and SEC v. Davidoff, which emanated from the Boesky case and involve allegations of "parking" and, in the case of Jafferies, price manipulation as well, are also described.

SEC v. Dennis Levine, et al.
86 Civ. 3726 (RO) (S.D.N.Y. 1986)

In May of 1986, the Commission brought what was then its largest insider trading case against Dennis Levine, a New York investment banker. The Commission alleged that Levine made $12.6 million over a six year period by trading in the securities of at least 54 issuers while in possession of material nonpublic information about actual or proposed tander offers, mergers, and other business combinations. The Commission alleged that Levine learned of these impending transactions, in many cases, through his employment as an investment banker.

On June 5, 1986, Levine consented to a permanent injunction against future violations of the federal securities laws and agreed to disgorge $11.6 million in illicit profits obtained as a result of his insider trading. Levine also agreed to the issuance of an administrative order permanently barring him from the securities industry. On the same day, Levine pled guilty to one count of securities fraud, two counts of income tax evasion, and one count of perjury, all arising from his participation in the insider trading scheme. On February 20, 1987, Levine was sentenced to two years in prison and fined $362,000.

The Commission's continuing investigation subsequently led to a series of cases against five individuals who participated with Levine in his insider trading scheme. 5/ These individuals worked at other investment banking firms or, in the case of one individual, at a law firm, and they allegedly participated in the scheme by misappropriating information from their firms and passing the information to Levine. One of the individuals also allegedly traded securities while in possession of material, nonpublic information provided to him by Levine. Each of the individuals

5/ SEC v. Robert M. Wilkis, et al., 86 Civ. 5182 (S.D.N.Y. 1986); SEC v. Ira B. Sokolow, 86 Civ. 5183 (S.D.N.Y. 1986); SEC v. David S. Brown, 86 Civ. 7774 (S.D.N.Y. 1986); SEC v. Ilan K. Reich, 86 Civ. 7775 (S.D.N.Y. 1986); SEC v. Randall D. Cecola, 86 Civ. 9735 (S.D.N.Y. 1986).

consented to a permanent injunction against future violations of the securities laws, and the four individuals associated with investment banking firms also agreed to be permanently barred from the securities industry. The defendants also agreed to pay a total of $3.7 million in disgorgement and $875,000 in civil penalties. Each of the defendants also pled guilty to criminal charges arising from the insider trading scheme. Three of the defendants received sentences of 366 days in prison, one defendant received a 30 day sentence and was fined $10,000, and the remaining defendant was sentenced to six years probation.

SEC v. Ivan F. Boesky
86 Civ. 8767 (S.D.N.Y. 1986)

On November 14, 1986, the Levine investigation resulted in the institution of the largest insider trading case in the Commission's history against Ivan F. Boesky, a New York City arbitrageur. The Commission alleged that Boesky caused certain affiliated entities to trade in securities while in possession of material nonpublic information provided to him by Levine. As part of the settlement of that action, Boesky consented to the entry of a permanent injunction and agreed to pay $50 million in cash as disgorgement of profits obtained by his affiliated entities as a result of the illegal insider trading, and to pay a penalty consisting of securities having an estimated aggregate value of $50 million.

In its complaint against Boesky, the Commission alleged that Levine provided Boesky with information concerning a number of tender offers, mergers or other business combinations or extraordinary corporate transactions. Levine allegedly obtained the information by virtue of his employment as an investment banker and from several other persons who similarly obtained the information by virtue of their employment at various investment banking firms.

The Commission also alleged that Boesky agreed to pay Levine approximately $2.4 million out of the profits received from Boesky's use of the inside information. However, the Commission filed its complaint against Dennis Levine before he received any money from Boesky.

As part of the settlement with the Commission, Boesky also consented to the entry of an administrative order barring him from the securities industry. The order entered by the Commission provided that the bar would be stayed until April 1, 1988, or such earlier time as the Commission may prescribe, to permit an orderly and smooth transfer of control of Boesky's present businesses. On March 12, 1987, the two broker-dealers controlled by Boesky, Seemala Corporation and I.F.B. Managing Partners, withdrew their registrations with the Commission as broker-dealers and thus, Boesky is no longer associated with a broker-dealer.

Boesky agreed to cooperate with the Commission in its continuing investigation and to disclose truthfully all information pertaining to his activities and the activities of others about which the Commission might inquire. Boesky also agreed to plead guilty to a federal felony charge arising from the insider trading violations.

SEC v. Martin A. Siegel
87 Civ. 0963 (S.D.N.Y. 1987)

On February 13, 1987, the Commission filed an injunctive action against Martin A. Siegel, another New York investment banker, alleging that he disclosed material nonpublic information obtained by virtue of his employment to Ivan Boesky. Siegel allegedly disclosed the information to Boesky under circumstances in which Siegel knew that Boesky would cause certain affiliated entities to trade while in possession of the information. Siegel allegedly received approximately $700,000 from Boesky in return for the information.

Siegel consented to the entry of a permanent injunction and agreed to disgorge cash or cash equivalents in the amount of approximately $4.25 million. Siegel also agreed to disgorge his ownership interest in securities of the investment banking firm which employed him at the time of the action and in partnerships sponsored by that firm or its subsidiaries. In a related administrative proceeding, Siegel consented to the entry of an order barring him from the securities industry. He also pled guilty to two felony charges arising out of insider trading violations and is currently awaiting sentencing.

As noted above, the Commission's continuing investigation into these matters has also led to the filing of several cases involving securities law violations other than insider trading.

SEC v. Boyd L. Jefferies
87 Civ. 1804 (S.D.N.Y. 1987)

On March 19, 1987, the Commission instituted an action against Boyd L. Jefferies, Jefferies & Co., a broker-dealer owned by Jefferies, and Jefferies Group, the parent company of the broker-dealer. The Commission alleged that the defendants violated the securities laws by engaging in market manipulation and in the "parking" of securities. Each of the defendants consented to the entry of a permanent injunction and agreed to cooperate with the Commission in its continuing investigation.

The Commission's complaint alleged that Jefferies entered into an agreement with another person to effect a series of transactions in a security in order to maintain or raise the price of the stock to close at a certain level the day before a public offering.

According to the complaint, the other person agreed to protect Jefferies against any losses that might result from subsequent sales of the stock. Jefferies & Co. subsequently sold the stock at a loss and was compensated for the loss pursuant to an invoice which falsely reflected that the payment was for "investment banking services."

The Commission also alleged that Jefferies entered into an agreement with Ivan Boesky to "park" stock owned by Boesky entities at Jefferies & Co. in order to conceal the inability of a broker-dealer controlled by Boesky -- Seemala Corporation -- to maintain the minimum net capital required by the Commission of broker-dealers. Boesky and Jefferies allegedly agreed that Jefferies & Co. would hold the securities for Seemala, and that Seemala would buy back the securities shortly after each transfer. Seemala was to receive all profits and sustain all losses from the transactions.

The Commission further alleged that one of Seemala's securities parked at Jefferies & Co. dropped substantially in value, leaving Jefferies & Co. with an approximate $3.6 million loss when it "sold" the securities back to Seemala. Boesky then paid Jefferies & Co. $3 million pursuant to a false invoice created by Jefferies & Co. for purported "investment advisory and corporate financial services" rendered. The complaint also alleged that Jefferies & Co. parked its own securities at various Boesky entities, including Seemala, under a similar arrangement.

In a related administrative proceeding, Jefferies consented to an order barring him from the securities industry. The order provides that Jefferies may apply for re-entry into the securities industry after the greater of five years or the period of any penalty imposed on him in connection with criminal proceedings.

In the same proceeding, Jefferies & Co. agreed to a censure and was ordered by the Commission to comply with its undertakings to, among other things, retain an outside consultant and implement recommendations made by that consultant concerning policies and procedures designed to prevent future violations of the securities laws. Jefferies & Co. must also retain another consultant to review the implementation of those policies and procedures.

On April 16, 1987, Jefferies pled guilty to two felony charges arising out of the activities which led to the Commission's actions. He is currently awaiting sentencing.

SEC v. Michael Davidoff
87 Civ. 2299 (S.D.N.Y. 1987)

Most recently, on April 7, the Levine/Boesky investigation led to the filing of an injunctive action against Michael Davidoff, formerly the chief trader at Seemala Corporation. The Commission

alleged that Davidoff aided and abetted violations by Seemala of the net capital and the broker-dealer books and records provisions of the securities laws. The complaint alleged that Davidoff engaged in non-bona fide sales to other brokers and dealers to create the false appearance that Seemala maintained the minimum net capital required by the Commission. The parties to the transactions allegedly agreed that the securities would be transferred back to Seemala within a short period of time.

Davidoff consented to the entry of a permanent injunction against future violations of the net capital and broker-dealer books and records provisions. He also consented to an administrative order barring him from the securities industry. In January, Davidoff pled guilty to criminal charges arising from the net capital violations. He is currently awaiting sentencing.

Other Important Insider Trading Cases

The Commission has also recently brought a number of significant insider trading cases which were not related to the Levine and Boesky investigations.

SEC v. The First Boston Corp.
86 Civ. 3524 (PNL) (S.D.N.Y. 1986)

The Commission's case against The First Boston Corporation, brought in May 1986, was the first case in which the Commission alleged that a securities firm had engaged in unlawful trading for its own account while in possession of material nonpublic information received from an investment banking client. First Boston allegedly received confidential information from a client corporation concerning a forthcoming announcement that the corporation would make a $1.2 billion addition to its property-casualty loss reserves. Upon obtaining the information, the corporation was placed on First Boston's restricted list. In addition, First Boston's "Chinese Wall" procedures prohibited the communication of this information to its trading department. Notwithstanding the firm's procedures, a First Boston insurance analyst communicated the information to persons in the trading department, who then disregarded the restricted list and sold the corporation's stock and purchased put options.

First Boston consented to the entry of a permanent injunction against future violations, agreed to disgorge profits of $132,138 derived from the alleged trading violations, to pay a $264,276 civil penalty, and to review and report back to the Commission on modifications of its restricted list and "Chinese Wall" procedures.

SEC v. Harvey Katz, et al.
86 Civ. 6088 (S.D.N.Y. 1986)

On August 7, 1986, the Commission filed an action against Marcel Katz, formerly a financial analyst at an investment banking firm, and three others alleging insider trading in connection with the merger between RCA Corporation and the General Electric Company. The Commission alleged that Marcel Katz obtained material nonpublic information concerning the merger by virtue of his employment and disclosed that information to his father, Harvey Katz. Harvey Katz allegedly purchased RCA securities for himself and others, and also disclosed the information to Elie Mordo, Harvey Katz's father-in-law and Marcel Katz's grandfather, and the other defendants, who also purchased RCA securities.

Each of the defendants consented to the entry of a permanent injunction and agreed to disgorge their profits. Harvey Katz, Marcel Katz and one other defendant also agreed to pay civil penalties under ITSA. Harvey Katz agreed to disgorge $1 million and to pay a civil penalty of $2.1 million. The other defendants agreed to disgorge $1.1 million and to pay approximately $190,000 in penalties.

The Katz case was significant because it was the first civil action filed by the Commission based on evidence obtained under the 1982 Memorandum of Understanding ("MOU") between the United States and Switzerland. The Commission used the MOU to identify a defendant, Elie Mordo, as the purchaser of RCA stock through a Swiss bank and to freeze his profits pending resolution of the case. The Commission's request for the information was reviewed and granted by the Swiss Bankers Association, in keeping with the procedures set forth in the MOU. The purchasers sought to block delivery of the requested records by appealing the matter to the Swiss Federal Tribunal, the Swiss supreme court. The Swiss Federal Tribunal affirmed the Commission's right to obtain the requested information. That decision was ratified by the Swiss Federal Council, the highest political body in Switzerland.

SEC v. Michael N. David
86 Civ. 9462 (S.D.N.Y. 1986)

In December 1986, the Commission filed an action against Michael N. David, formerly an associate with a New York City law firm, alleging that he misappropriated material nonpublic information from the law firm concerning proposed or considered corporate takeovers. David allegedly conveyed the information to persons who traded in the securities of the takeover targets for their own accounts or for an account in which David had a beneficial interest. Those persons also allegedly conveyed the information to others who also traded in the securities of the takeover targets.

David consented to the entry of a permanent injunction against future violations, and agreed to disgorge $50,000 and pay a civil penalty not to exceed $100,000.

The Commission's investigation of the insider trading scheme in which David was involved also led to indictments against David and four others for their participation in the scheme. 1/ The indictments charged, among other things, that David misappropriated the information from the law firm and passed it to Morton Shapiro, a stockbroker. Shapiro allegedly used the information to trade in an account for the benefit of himself, David, and Daniel Silverman, an investor. David also allegedly shared the information with two analysts at securities firms, Andrew Solomon and Robert Salsbury. 2/

All of the defendants pled guilty to charges arising out of the indictments. Shapiro was sentenced to two months in prison and received a $25,000 fine. Silverman received three years probation, was required to perform 200 hours of community service, and received a $25,000 fine. Salsbury was sentenced to three years probation. Solomon was sentenced to one year of probation and received a $10,000 fine. David is currently awaiting sentencing.

SEC v. Alfred Elliot
Civ. Action No. 86C10184 (N.D. Ill. 1986)

On December 30, 1986, the Commission filed an action against Alfred Elliot, formerly a partner in a Chicago law firm. The complaint alleged that Elliot purchased the stock of companies which were clients of the law firm or which were acquisition targets of the firm's clients while in possession material nonpublic information obtained by virtue of his employment at the law firm. The information concerned actual or contemplated mergers, tander offers, and other extraordinary corporate

---

1/ U.S. v. Andrew Solomon, 86 Cr. 451 (GLG) (S.D.N.Y. 1986); U.S. v. Daniel J. Silverman, 86 Cr. 452 (GLG) (S.D.N.Y. 1986); U.S. v. Robert Salsbury, 86 Cr. 453 (GLG) (S.D.N.Y. 1986); U.S. v. Michael David, 86 Cr. 454 (JFK) (S.D.N.Y. 1986); U.S. v. Morton Shapiro, 86 Cr. 455 (GLG) (S.D.N.Y. 1986).

2/ In January 1987, The Commission instituted an injunctive action against Robert Salsbury based upon his participation in the scheme. SEC v. Robert Salsbury, 87 Civ. 0097 (JES) (S.D.N.Y. 1997). Salsbury settled the proceeding by consenting to a permanent injunction against future violations of the securities laws. In a related administrative proceeding, Salsbury consented to the entry of an administrative order barring him from the securities industry and providing him with a right to apply for re-entry into the industry after three years.

transactions. Elliot consented to the entry of a permanent injunction, and agreed to disgorge profits of $271,312 and pay a civil penalty of $228,688.

SEC v. Israel G. Grossman, et al.
87 Civ. 1031 (SWK) (S.D.N.Y. 1987)

In February of this year, the Commission instituted an action against Israel G. Grossman, a former associate at a New York City law firm, and six others for trading while in possession of material nonpublic information allegedly misappropriated by Grossman from the law firm. The Commission alleged that Grossman misappropriated information from the law firm concerning a recapitalization of a client, and passed that information on to the other defendants. Those defendants allegedly traded while in possession of the information, realizing illegal profits of approximately $1.5 million. In supporting papers filed in the action, the Commission alleged that the defendants attempted to conceal their activities from the Commission by fabricating a story concerning the reasons for their trading. The Commission is currently litigating the case against all seven defendants.

Grossman has also been indicted for criminal violations arising out of the insider trading scheme.

SEC v. Nahum Vaskevitch, et al.
87 Civ. 1630 (RWS) (S.D.N.Y. 1987)

On March 11, 1987, the Commission filed an action against Nahum Vaskevitch, formerly a managing director in charge of mergers and acquisitions at the London office of a U.S. broker-dealer, David Sofer, an Israeli businessman, and two entities. The Commission alleged that Vaskevitch provided Sofer with material nonpublic information obtained during the course of his employment concerning mergers, tender offers, and other extraordinary corporate transactions. Sofer allegedly traded while in possession of the information through accounts in the names of the two entities. The defendants allegedly realized over $4 million in illegal profits as a result of the scheme.

The Commission is currently litigating the case. On March 30, the Commission obtained a preliminary injunction against future violations of the antifraud provisions of the securities laws, an order freezing assets, an order for an accounting, and an order preventing alteration or destruction of documents.

Conclusion

The Commission is currently in the midst of one of the most important and intensive series of investigations it has ever conducted. The conduct which has already been exposed demonstrates

that insider trading is a very serious problem. Moreover, the ongoing investigations have expanded beyond insider trading to equally serious violations of the federal securities laws, such as market manipulation and "parking" transactions. While the investigations separately conducted by the Commission and the U.S. Attorney's Office for the Southern District of New York continue, the cases brought during the past year have already served notice on persons who contemplate engaging in securities fraud that the probability of detection, as well as the severity of the sanctions, have substantially increased.

Senator RIEGLE. Thank you very much.

Senator GARN. Mr. Chairman, before you proceed, Senator Chafee was not able to stay and I would just ask unanimous consent that his statement be placed in the record.

Senator RIEGLE. Without objection, it will be placed in the record.

STATEMENT BY SENATOR JOHN H. CHAFEE

Senator CHAFEE. Mr. Chairman. I am deeply distressed at the results of the recent and ongoing investigations of the securities industry. It is my belief that the language defining insider trading should be sharpened to make more explicit what is and what is not culpable and criminal behavior. I look forward to the comments of our panelists today on this matter and I understand that an appointed group of lawyers should report by May 25 on suggested new language. In return, I feel penalties should be toughened up so that anyone convicted under a newly defined insider trading law, who has in any way profited financially, should serve some time in prison. And I mean prison and not a country club. Why should the perpetrators of white collar crime be treated any differently than those of blue collar crime?

Why do I feel this way? Because of those to whom much is given, much is expected. As the new law should help to clarify the major areas of question about acceptable behavior, it would be up to the individual to understand the law or seek counsel from his or her company, which should be provided. As the fear of public humiliation and financial sanctions do not seem to be sufficient deterrent, the threat of certain incarceration may be the additional sentence required to encourage proper activity.

I hope that resolution of this saddening matter will receive the highest priority.

Senator RIEGLE. Mr. Giuliani, you say that about 15 or 20 percent of the resources of your office—and you have to cover all Federal crimes, drug issues, other things that you cited—a very substantial portion of your resources are now having to go into the securities laws violations, insider trading type issues here.

SEC RESOURCES

As you have found yourself dealing with these problems, what's your view on the adequacy of the SEC's resources? We're looking at an increase of roughly 30 percent for the coming year, but that is after the SEC has been held pretty much at the same level for a long period of time.

I'm wondering that it looks to you like given this explosion of activity that maybe their staff ought to be doubled or increased by 50 percent or what can you tell us about that?

Mr. GIULIANI. I really don't know what the appropriate level would be. It would seem to me that a 30 percent increase would be about as much as you could realistically do in 1 year, given the need to hire people and train them.

If I were relating to my own office it would be easy to say, well, I'd like to double the size of my office, but as a realistic matter, you couldn't do that in 1 year. So 30 percent sounds like a responsible

increase given the level of the problem and what you can realistically do in a year, but I think you probably have to be thinking in terms of what's the increase going to be the year after that and the year after that.

There's no doubt that the problem is a bigger problem than we thought existed in the past and the SEC bears a much heavier burden for dealing with the problem than we do. Far many more cases—Gary Lynch would know this better than I do, but it's probably three times to four times as many are handled civilly as are handled criminally. That will pretty much remain the same. That's not going to change very much.

Senator RIEGLE. Isn't it fair to say that basically they have to do the early detective work to shape a case that they then bring to you at some point, is that correct?

Mr. GIULIANI. That's correct. They're dealing with three to four times as many cases. Sometimes the civil cases are even more complex than the criminal cases and all of these cases are labor-intensive cases. They require numerous lawyers, numerous investigators. The people on the other side generally have resources and litigate the case, are represented by fine lawyers and usually with large staffs. So these are not like a 2-buy narcotics case that you can prosecute in a couple of days.

Senator RIEGLE. It sounds to me, too, as if what Mr. Lynch has just said is that this investigation continues to open up new areas of difficulty and improper activity. You were saying a minute ago, Mr. Lynch, that pooling activity or parking activity—and you mentioned one other——

Mr. LYNCH. Market manipulation.

Senator RIEGLE. Market manipulation are now areas that in a sense have come into view as these other cases have developed and so, if I heard you correctly, you were saying you see that as taking a major new emphasis over say the next 12 months. That sounds to me like you're going to keep a lot of people busy and it sounds to me like the resource problem may be a real one.

I would be interested in your assessment on that. I realize you're speaking for yourself and not for the SEC at the moment, but how serious is the resource pinch now just to be able to cover this waterfront with these problems widening out this way?

Mr. LYNCH. It is a serious problem right now. We are trying to hire more people. We have received authority even in the current year to hire about 35 more people in the Division of Enforcement in the home office and we are recruiting and interviewing people and making offers. But it takes a while to get those people onboard and train them such that they can jump into an investigation.

And we have at least 20 professionals who are working on investigations just coming out of the Levine-Boesky-Siegel series of investigations, plus we've opened up any number of other investigations dealing with insider trading and other problems that are unrelated to the Levine-Boesky series of investigations.

So right now we are having a crunch. We are having difficulties in staffing up all our investigations. We're doing it, but it's getting to the point now where we certainly could use more people onboard.

Senator RIEGLE. Now, Mr. Giuliani, you stated very clearly—and I appreciate your being so direct about it—the fact that you think a tighter insider trading definition would have a real value from the point of view of law enforcement and putting an end to some of these practices.

Mr. Lynch, in the past you've indicated you would oppose any definition of insider trading that narrows the case law or discards the misappropriation theory and I want to pose the question to you this way. As you know, I've requested a group of outstanding securities lawyers which is traveling by the name of the "Pitt Commission" to draft a proposal designed to clarify the law on insider trading.

If they, working with you and others on the commission, come up with a clarification that neither narrows the case law so that it would sidestep that concern you have, nor discards the misappropriation theory which is the other concern you had, would you then feel that it would still not be sound to go ahead in this area or would your mind be open to a tighter and a more specific definition of insider trading?

Mr. LYNCH. I'm definitely open to it. I've never been opposed to a definition of insider trading. I think the problem is arriving at a consensus as to what the definition should be.

I would oppose any definition that narrows what the current law is and I certainly would oppose a definition if it introduced some sort of evidentiary burdens on us that don't currently exist. As I pointed out in the opening statement, insider trading cases are already very difficult to prosecute, and to the extent that a definition made it even more difficult, obviously, I would oppose that kind of definition.

Senator RIEGLE. Of course, it can cut the other way, too, because it seems to me you both have testified that these cases are so arcane, they are so hard to reach—people don't advertise what they're doing—that if you have a law that is more precise in fact without having the defects which you cite you may very well have more of a deterrent effect that Mr. Giuliani was talking about, and that is, if you have tougher penalties and you make it clear that people can really get nailed, it seems to me we may put a real dent in this problem with a better definition.

So we are going to continue to see if we can't develop that along the lines that also meet your concerns.

The CHAIRMAN. Thank you, Senator Riegle.

Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman.

I wish us all good luck on coming up with that better definition on insider trading. We've struggled over it and hopefully we will succeed. And I would be very appreciative of any help that both of you might give us in this important area, if we can, because you have the ultimate burden of proving these cases. Consequently, I think the lack of a definition creates opportunities for those represented by major law firms to play fast and loose and slip into the loopholes left open by case law. These loopholes ultimately make it increasingly difficult to get convictions.

By the same token, we must be sensitive to the problem Mr. Lynch recognized: we should avoid a definition that begins to

narrow that and allow activities that heretofore have been considered to be illegal to be permitted.

Crafting a definition is easier said than done, but I would certainly think that both of you should assist us in our efforts.

BETTER SELF-POLICING

U.S. Attorney Giuliani raised a point and you said that one of our first lines of defense should be to get a better self-policing system into the various firms, whether they be the law firms, whether they be the investment banking firms, the bankers, etc., and I believe that to be the case.

In some cases I don't believe that these systems exist. They may exist on paper, but to adequately go through and spell out the rules is often lacking. Firms must specify a code of conduct that will be strictly adhered to. I think that maybe at one time the fine old firms had a tradition that has over the years has just kind of watered down.

Recognizing that I have introduced legislation that contains a provision imposing a civil fine of up to the amount of the moneys that were illegally made or gained upon the firm. Of course, the individual is still responsible. We have the triple damages as provided by the Insider Trading Act of 1984 as well as the prison sentences. Additional, we should consider imposing fines on that firm for those who knew or should have known that their employees are engaged in this kind of illegal activity.

I would like to get the comment of both of you with respect to that provision, as to whether or not you think that would be the kind of thing necessary to begin to help bring about compliance and make those firms more vigilant.

Mr. GIULIANI. I think the concern is a very valid one because in fact——

Senator D'AMATO. Do you believe that burden to be too much for the businesses to have placed on them?

Mr. GIULIANI. I think something has to be done to get them to pay more attention to an area that at least in the past they didn't think was worth the kind of attention that it requires.

If you look at some of the early cases, particularly those involving law firms, you will see that they involved proofreaders, people who were paralegals, people who were clerks, and then lawyers and then partners in the law firm. And you could easily come to the I think very valid conclusion that the whole question of confidential information was being treated in a very cavalier way. In other words, there wasn't very much being done to remind people that this information should be kept on a "need to know" basis, that it could have a dramatic effect on the market, that one group of people could use it to vicitimize others. And where there are more than just isolated violations, I think it would be appropriate to have a civil penalty to get their attention.

I think that firms should have the ability to show that they have done everything that you reasonably could do to avoid this kind of activity, yet they were victimized by one or two errant employees.

I find in making the determination as to whether or not to indict a firm criminally, which is a very, very broad defintion, particular-

ly in the 2d circuit, basically a corporate enterprise can be indicted if any employee at any policy level commits a crime if it benefits the corporation. Many times it's fair to do that and many times it's unfair to do it, and the major factors that you apply in deciding it are, did the corporation really make a good faith effort to protect itself from being victimized by a dishonest employee or two dishonest employees or three, or did it in fact just not pay attention to these problems.

And if a firm showed that it did everything it reasonably could do to educate their employees about insider trading, if it took reasonable steps to secure the confidentiality of the information, yet they had an employee or two that traded on inside information, I don't know that I would penalize that corporation.

But if the corporation is doing relatively nothing about it, then I think it is appropriate, even if you can't impose criminal liability on them, to have a form of a fine or something that would get their attention.

Senator D'AMATO. So you don't believe that that legislation places an undue or onerous burden on the firm?

Mr. GIULIANI. I think if you built into it the ability of a firm to show that it made good faith efforts to avoid this problem, in essence to avoid the problem of insider trading or securities fraud or whatever, I think it would be a very helpful piece of legislation and it would be very fair.

Senator D'AMATO. Mr. Lynch, do you have an opinion on that?

Mr. LYNCH. My reaction is much the same as Mr. Giuliani's. To the extent that the penalty would be imposed only if one could show that the firm knew or should have known that there was a violation, then I don't think it would be unfair to have that kind of penalty.

In fact, at the current time, a number of firms have found that they're defendants in civil actions where the potential liability is huge, so there may be firms right now that may find that they will have to pay out substantial amounts in private litigation.

I don't think it would be a good idea to have a penalty that is imposed on the firm on the basis of respondent superior, that the employee violated the law and therefore the firm should be liable. There are situations where it's hard to imagine what a firm could do, whether it's an investment banking firm or a law firm or any other kind of organization if you have an employee who's hell-bent on trading on insider information. They make calls from telephone booths. They reverse the charges to the Bahamas, as one of the defendants recently did in one of our cases, and there is nothing that the firm could do to really pick up that the person within the firm was trading on the information.

But to the extent you had either a knowledge or a recklessness or negligence requirement, then I don't think it would be unfair.

Senator D'AMATO. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato.

Mr. Lynch and then Mr. Giuliani, can you tell us why Members of Congress should be concerned with insider trading? Why should we have laws at least as strong as the laws we presently have on the books? Does insider trading demean and damage the capital markets of our country. If so, why and how?

Mr. LYNCH. Well, the argument that insider trading is good for the markets is an interesting academic argument, but I really think it has no practical application at all to the markets that we have in the United States.

People believe that when they go to the securities markets they are going to be dealt with fairly and to the extent that we had a system where an insider of a company could make millions of dollars simply by virtue of the fact that he was an insider of a company and could take positions in the company's stock based on inside information to the detriment of shareholders in the company or people who were considering buying stock in the company, I think we wouldn't have the good markets that we currently have.

Certainly I can't imagine a system where there was absolute parity of information in the marketplace. There will be people who because of their analysis of publicly available information, because they're smarter than other people and put more time and effort into it, will be in a better position to reach investment decisions than other people. There's no question about that.

But on the other hand, they shouldn't have access to inside information such that they are not, like everyone else in the market taking positions based on publicly available information.

Were this country to decide that we don't need insider trading laws, it would be a severe blow to the capital formation process.

The CHAIRMAN. Thank you. Mr. Giuliani.

Mr. GIULIANI. I agree with Gary Lynch's analysis and I think I would add to it this. Very often when the argument is raised as to whether there should be legislation against insider trading, there's a red herring that's raised and I think Gary touched on it, and that is that the thrust of the insider trading laws is to make everyone feel that they are in the same position, that they all have the same information available to them, and that's just unrealistic and unfair.

In fact, that isn't the case. It is not a violation of the insider trading law to have more information than someone else or to have done more analysis than someone else. It's pretty specific what the core violations of insider trading are.

If someone in a position of responsibility who has a fiduciary relationship like a chief executive or major executive in a corporation or an investment banker who's working on a deal or a lawyer—professionals who are highly paid to do what they are doing—comes upon information in the course of his duties from which he could personally profit by defrauding others, he's not entitled to do that.

It seems to me that that's inherently wrong. If I am a lawyer and I'm retained by a corporation and the corporation says, "Mr. Giuliani, we're going to pay you a $2 million fee in order to handle our takeover battle," and I realize that this corporation is going to

offer $20 a share more for the stock of corporation "x" and I go out and buy stock, what I'm essentially doing is taking what I know surely, just as the person who knows that the wrestling match is rigged or the person who knows who's going to win the horse race—I know the answer. I know that that stock in 3 days when that public information becomes public it will have the effect on the market of raising the price of the stock that I'm buying by $20 a share. I have essentially taken out of the pocket of the person who was not retained by the corporation as a lawyer, paid $1 million or $2 million as a fee—I've taken that $20 a share out of that person's pocket and put it in my pocket. That's simple, elemental fraud.

That was the rationale for passing the insider trading statutes 50 years ago—at least the individual rationale for it. The overall rationale was that one of the perceptions of the people who studied it at the time was that insider trading and the notion that Wall Street and the financial community were controlled by insiders who were the presidents of corporations and the lawyers and the investment bankers, that that perception helped to contribute to the Stock Market Crash of 1929 and I think you can understand how on a broader basis that could happen if the perception was that people who have confidential fiduciary relationships for which they are highly paid are using those relationships to take money out of the pockets of people who are not in that kind of privileged position. I think the rationale makes a great deal of sense. It's very consistent with the rationale of other fraud statutes that the Congress has passed and that are matters of criminal legislation under most State laws, and I think that there is some misunderstanding of the reach, at least criminally, of the insider trading statutes, but if you focus on what the core violations are, it becomes pretty obvious that it's essentially the same thing as common law fraud.

The CHAIRMAN. Well, thank you very much, gentlemen. Insider trading is wrong, this is fraud. This is theft. This is unethical. And there's a practical factor, too, and that is it destroys our capital markets. People figure they're playing with rigged dice. Why get into a game where the house has the control of the slot machines.

Now Senator Hecht.

Senator HECHT. Being from Nevada, we have to watch how we talk about slot machines. [Laughter.]

Thank you, Mr. Chairman.

Laws have far-reaching ramifications and the power of Congress to make laws is awesome.

INSIDER INFORMATION

Let me ask you, Mr. Giuliani, a hypothetical question. Let us just say there's a real estate development firm that decides they want to buy a tremendous amount of acreage for a great, huge shopping center. Someone in that firm notifies a friend of his who buys real estate. They go out and they buy a piece of real estate knowing full well that tomorrow this big real estate development is going to be across the street from a piece of property some people have had for 25 years. They've lived in the house. They own a few apartments in big—a large piece of property.

They sell this property to this person for $250,000. They double escrow it for $1 million. The person comes back to you and says they had inside information about that.

How would you handle that?

Mr. GIULIANI. Well, it really depends on how far they went to misrepresent the facts. Assuming that they didn't disclose the fact that they were going to use that property and the property was going to be a lot more valuable, they did nothing affirmative to mislead—they just didn't disclose, under most State statutes, that would not amount to fraud because there wasn't a fiduciary relationship—there wasn't a duty to disclose.

If, however—and there have been cases in which people have been prosecuted for doing this—they went about doing anything affirmative to try to hide their plans and therefore affirmatively deceived the person at the other end of that transaction, they could then be prosecuted for misrepresentation.

And the difference is that in the real estate business the law has generally not found a fiduciary obligation or fiduciary relationship between the purchaser and the seller, whereas in the securities markets there are people who are employed and brought into very special fiduciary relationships where they are given the information for a very specific purpose.

The reason the lawyer is brought into the takeover deal is not so that he can personally profit and not so that he can take advantage of others who aren't the lawyer on that deal. He's brought into the deal to handle litigation, to advise on the takeover, to do things for the benefit of the corporation and he has a fiduciary obligation that does exist and therefore his duties to disclose become greater, and the rationale for all that is very well supported in general fraud law, not just insider trading law.

Senator HECHT. Do you see any comparable similarities between the hypothetical question I asked you and insider trading laws?

Mr. GIULIANI. I do. The line between ethics and illegality is always a very close one. It depends on how legislatures and Congress and courts interpret things. You could say that there is something of a sharp practice in knowing that you're going to make a material change and not disclosing it. But the law, where there hasn't been a defined fiduciary relationship doesn't require you to make disclosure of that.

But if you go a step further and you try to affirmatively create the impression, for example, that there is not going to be a shopping center developed so that people would be more likely not to think about that and therefore not raise their asking price, you would then be guilty of the crime of fraud.

Senator HECHT. As you mentioned and I mentioned earlier, there is certainly no lack of confidence in Wall Street today. I think publicly you have done an excellent job. You and I have never met before but I've read about you. I think you have done an excellent job.

Is there any type of laws that you felt that you needed to do a better job or were you able to do it with the existing laws on the books?

Mr. GIULIANI. I think that by and large, from the point of view of criminal prosecution, the laws are adequate. There are some refine-

ments that I think should be considered, like a definition of insider trading, or the penalty possibly increased. I think from the criminal prosecution side, the major thing that has to be looked at is resources—increasing the resource of the SEC because it's a much larger problem and then in a proportionate way increasing the resources of the Justice Department and the U.S. attorney's offices to handle the additional criminal cases that come out of all that. I think that's the primary thing that has to be done.

In a more general way, I think many of the things that the chairman has discussed and other members of the committee have discussed are things that are worthwhile taking a look at—the 13(d) requirements and many of those things might have contributed to some of the increase in insider trading that's gone in this 3 or 4 years. But from the purely criminal aspect, I think the statutes are adequate. Some increases in the penalties, a more precise definition to end the debate, and mostly more resources.

Senator HECHT. Thank you very much.

Mr. GIULIANI. Thank you.

The CHAIRMAN. Thank you, Senator Hecht.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

Mr. Giuliani, I thank you for a very excellent statement and I share the opinion that's been expressed at the sense of confidence that you bring to this important position that you now hold and I commend you for your efforts.

You made a dramatic statement relative to the level of prosecution under the insider trading act of the first 50 years and now for the last 3 years.

CONTRIBUTING FACTORS FOR INCREASED PROSECUTIONS

What are the factors that you think contributed to a historic pattern that had 12 prosecutions in 50 years and now has had 50 or more in 3 years?

Mr. GIULIANI. I don't really know precisely the answer to that question. I've thought about it and I've been asked the question a good deal and I don't know in what order you would put the following two factors. I believe obviously there must have been and has to have been an increase in the amount of insider trading and related kinds of securities fraud and I know that the SEC and the Justice Department have spent more time and more resources looking at the problem in the last several years than had ever been the case before.

Which of those two factors is the more prevalent, I don't think I know the answer to and I'm not sure too many people do because we, unfortunately, didn't keep statistics about white collar crime and securities fraud and insider trading and we don't have too many ways of really gauging how extensive was it in the 1940's, how extensive was it in the 1950's, in the 1960's, in the 1970's, and how much worse it has become in the 1980's.

Then I think that luck and fortuitous circumstances have something to do with it. The right people decided to cooperate and to give information and expand things and one thing led to another so that you get a window of opportunity now that maybe you didn't

have 5 or 10 years ago and we should take advantage of that to try to reverse what appears to be a fairly extensive problem.

Senator GRAHAM. One reason which has been cited as a possible generator of increased insider trading activity has been the increase in corporate takeover activities.

To what degree do you or Mr. Lynch wish to comment as to the extent to which there is a causal relationship?

Mr. LYNCH. Well, I definitely think there is a causal relationship. If one had inside information that there was going to be a dividend increase and the stock might rise two or three points, that's one thing. On the other hand, if you know that the price of a stock is going to double in 2 days when an announcement comes out that a takeover is going to be launched or that a friendly merger has been agreed to, then that's quite another thing.

The amount of money that can be made on trading on inside information concerning an impending takeover is generally going to be much larger than the amount of money one can make trading on other types of inside information.

Couple that with the fact that not only was there an increase in takeovers from the midseventies up to and through the early part of the 1980's, but also there was the advent of listed options trading so that someone could take a position and control a very large amount of securities with a relatively small investment.

We had one case where someone invested $3,000 in an options position and 24 hours later that $3,000 position was worth $430,000. So the ability to make money while in possession of inside information increased with more corporate takeovers and with listed options trading.

I do think—if I could just respond to your earlier question as well, we have gotten better at what we do. The surveillance systems are better. We are better investigators as well. We understand better now how one goes about making an insider trading case, what kind of documents to subpoena, where we go. We're also much better at dealing with foreign governments and getting information out of other countries.

And couple those facts with the fact that we have made a concerted effort at the SEC to work more closely with Mr. Giuliani's office and with other U.S. attorney offices around the country so there would be criminal prosecutions.

I think all those factors have led to the increase in criminal prosecutions over the last 3 years.

Senator GRAHAM. Mr. Chairman, if I could pursue it with one last question, Mr. Giuliani, you concluded your comments with some statements relative to ethics and values and you particularly stressed relative to young professionals who had been involved in this.

ETHICAL VALUES

To what degree do you sense that there has been a deterioration of ethical values over the 50-year period that has contributed to this, and from your experience with these individuals do you have any sense of the causation of that deterioration?

Mr. GIULIANI. Some of that sense, Senator, derives not just from the insider trading cases but from the tax evasion cases and the other fraud cases and the wide range of white collar criminal prosecutions that we do.

Very often people who come from what you would regard as very decent backgrounds and graduate from very good educational institutions—there doesn't appear to be a reason for why they would be violating a law. And by no means is this the sole reason and the only reason and there are many others, but I do think that in the last 20, 30 or 40 years the institutions in our society that we have relied on to teach values have to some extent deteriorated. They don't have as much control over as many people as they had in the past. Fewer people grow up in stable families and that's been a trend for the last 20, 30, 40 years. Fewer people go to church. Fewer people exist in communities and grow up in communities where commonly accepted values are inculcated in people at an early age, and I believe most importantly and the place where government intersects with people most often, in primary education, we decided some time ago that we would go in the direction of valueless education because we were afraid that we would teach people one set of values or one person's values and not another's. I think there we may have made a mistake. Separating primary education from education in ethics was a very big mistake. You have to expose young people to ethical values at a very early age. It should be a very important part of primary education, including the reasons for our legal system, the reasons why we have laws, the reasons why you have to cede some of your autonomy to lawful authority, some of the basic ethical notions of Plato and Socrates and Aristotle that have nothing to do with anybody's particular religion.

I think maybe our fear and our misunderstanding of the difference between ethics and religion led us to think about primary education as an area where we should not be getting into ethics and we shouldn't be getting into values because we might be treading on the separation of the church and State. I think that had something to do with the fact that an awful lot of 20-year-olds have not been exposed to some of the basic values at an early enough age and in an impressive enough way so that when they start dealing with the pressures that exist in the marketplace or in law firms or wherever, some of the constraints that you expect would be there haven't been built into them.

Senator GRAHAM. Thank you.

The CHAIRMAN. Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

I would join with my colleagues in saying how much we appreciate the enforcement activities both of you and your organizations have undertaken.

LONGER PRISON TERMS

I wanted to go back, Mr. Giuliani, to the statement you suggested about perhaps needing longer prison times available because 5 years is the maximum.

Going through this chart that you presented, I was struck by the fact that it seemed to me from a very brief reading that more were getting probation and probably a minority only were doing hard time in prison, and I think there were a couple at 3 years and one at 3½ years.

It would seem to me, based on the discussions that have been held about deterrent sentences, that for this type of white collar crime the greatest deterrent to a potential criminal insider trader would be that he would actually go behind the doors and serve some time in the prison.

Would you comment on the need for a definite prison time as perhaps being—once you get to the point where there's a criminal violation, if the convicted defendant has to serve some prison time, is it not as effective to have him serve 1 year as to serve more years? Isn't that actually going behind bars the primary deterrent?

Mr. GIULIANI. I actually think that that's quite correct, Senator. I think that if you had to make a choice between a few people serving a long time in prison and many people who were convicted spending some time in prison, it would probably be more effective having many people spending some time in prison, particularly given the group of people that you're dealing with here who are people that have not—unlike organized criminals or drug dealers who build into their plans for their life the possibility that they're going to spend time in prison—these people have not planned on going to prison. Therefore, prison terms of a couple of years, even though they may seem to the public not to be adequate, have quite a dramatic effect not only on them but on their colleagues because they haven't planned to spend 2 or 3 years in prison the way the head of an organized crime family may have planned to spend 5 or 6 years and he meets all his friends in prison. And if we do our job right, some of these people will be meeting their friends in prison.

But I do think that consideration should be given even with that to increasing the sentences somewhat because, although it is true you don't need the same level of imprisonment to get the message across in this area as you might in some others like drugs and organized crime, your observation about the sentences is quite correct. The majority of people are not sent to prison. That's been changing somewhat. If you take a closer look at it, you'll see that increasingly more Federal judges are imposing prison sentences on people convicted of insider trading and the amount of the sentence continues to increase, although slowly.

But I think that a very, very effective message would be that the general rule when you're convicted of insider trading is that you go to prison. The length of time essentially is up to the judge depending on how serious the crime is and other extenuating circumstances, but you don't escape going to prison. At a bare minimum, you have to go to prison.

Senator BOND. In the brief time I have left I would like perhaps an answer from both of you but I would start with Mr. Lynch.

I would agree with your concepts that there need to be greater enforcement mechanisms to assure that there's no insider trading information that a so-called Chinese Wall does exist. I think there's a great deal of skepticism away from Wall Street among the people

who would be expected to put their money in the capital markets that these Chinese Walls can be effective.

Do you think they can be effective? Should a firm be banned from engaging in takeovers and arbitraging? What value would the arbitrageur provide? Can he work in a firm separated by a Chinese Wall from his partner who's a takeover specialist?

Mr. LYNCH. Well, I think they can work, actually. We brought a case earlier this year against one firm where there was a breakdown in the Chinese Wall procedures and we have information that there were problems in several other firms. But arbitrage trading by a firm is simply a firm trading in securities and they happen to be trading in securities prior to a takeover announcement. It's clear to me that a firm should not be arbitraging a deal that the firm is working on in its investment banking section. To the extent that that occurs——

Senator BOND. Would that be a violation in and of itself?

Mr. LYNCH. It would be a violation in and of itself at the current time if you could show that the person trading either had that information or it in any way influenced their decision or that the firm didn't have adequate procedures in place. If you could show that any information crossed over from the investment banking side of the firm to the arbitrage side of the firm, then you could prosecute that at the current time.

Senator BOND. I see my time is up. I appreciate your answers.

The CHAIRMAN. Thank you, Senator Bond.

Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

Just let me touch on something that I think both of our witnesses have raised and they've raised it both in their direct testimony and in response to questions from some of my colleagues here.

That is, the deterioration I think in ethics and the conduct that we witness with insider trading and with other market manipulation that's going on.

With reference to devices like a Chinese Wall, whether or not these devices will work are dependent on the code of ethics of those who work in these firms and whether or not the code of ethics will work it appears to me to depend in large measure on the character of those who have the responsibility for enforcing the code of ethics and supervising those who work there and of the actual workers themselves. And it appears to me that there's a connection between the insider trading that we see and this uncontrolled greed that we are witnessing in the field of corporate takeovers. There appears to me to be a connection many times between the insider trading and the manipulative tactics that are used in hostile corporate takeovers.

As a matter of fact, I am advised that most insider abuses have taken place in the context of hostile corporate takeovers or in the context of corporate takeovers generally.

REFORM TAKEOVER LAW

I would ask both of these witnesses if they would agree with that evaluation and if they do, do they have any suggestions about how

we might reform takeover law? Is simply requiring immediate disclosure of significant stock purchases—would that be helpful? In other words, closing the 10-day window, is that enough, do you think? Would you address this issue for me, please?

Mr. GIULIANI. I'll make an attempt, Senator. I think there's no doubt that there is a connection between the number of insider trading cases both criminal and civil now and the substantial increase in the number of takeovers, including hostile takeovers. And I think as Gary Lynch pointed out before, the reasons for that—at least the reasons that we can detect are that, first of all, that raised the rewards for insider trading. The amount of money that you could make substantially increased and it did another thing. It raised the number of opportunities in which you could trade on inside information because a hostile takeover will generally take place over a period of time and there's not only the first bit of public information that might have a dramatic effect on the market but then there are a lot of strategies that are employed. As those strategies become public, that has an effect on the price of the stock. The stock will either increase or decrease, depending on the strategy that's being employed and it's going to be announced.

Therefore, there's not only the initial opportunity to make a good deal of money, but all along the way there are opportunities to make money that is much greater than was the case before.

It is true that most of the criminal insider trading cases are insider trading cases that involved in some way a takeover, but it is not true that the majority of them involve people who were necessarily involved in the takeover battle.

It's often people who are on the outside who are getting improper information about it or some people that are involved in arbitrage or other functions.

But I do think that you hit on something that's important because in fact given the emphasis on the need to make a great deal of money, the need to turn over quickly large profits——

Senator SASSER. Because of the debt that's incurred many times in these attempts at corporate takeovers or corporate takeovers themselves, there is a need to make a lot of money in a hurry.

Mr. GIULIANI. It's an atmosphere where unless you balance that pressure with an educational system in the broadest sense even within firms as to the overall importance of acting honorably, acting decently, the overall importance of the long-term reputation of the firm and not just succeeding in this particular deal—unless you make specific affirmative efforts to balance the pressure that you've identified, there's every chance that people will violate either the insider trading rules or some other rules. We didn't understand the tremendous pressures that exist and that were being unleashed in these deals. There has to be something that balances that.

Now reducing the 13(d) period from 10 days to 5 or 3 days certainly isn't going to cure the problem, but it's probably an effective thing to consider. It will reduce the period of time. Then I think there are a whole host of other things that can help.

In the long run, though, it's a long-term problem of inculcating, educating and reminding people of what is the long-term goal of the capital markets, the need to act honorably and decently—and I

think maybe we can overdo it a little bit. For all of the deals that have been exposed as deals in which insider trading has taken place, still I think the vast majority of situations are situations in which people acted honorably and acted decently.

So although it's a problem, nobody should underestimate the problem, there are still I think the vast majority of people in the financial community are like the vast majority of people in society—decent, honest people.

Senator SASSER. Do you want to address that, Mr. Lynch?

Mr. LYNCH. Yes. I do think that the 10-day window in 13(d) should be closed. There is no reason in 1987 that a bidder or anyone who acquires 5 percent in a company needs 10 days to file a 13(d) with the Commission. Certainly a much shorter period—2 days I think is the period that's been suggested by the Commission—would provide ample time for a bidder to file the 13(d) with the Commission and alert the target company to the fact that they now have a 5-percent position. I think it would be very helpful.

I don't think that's going to eliminate the insider trading problem. I guess there will be somewhat of a lesser opportunity for people to trade on inside information that a person is going to make a bid for a company, but it's certainly not going to eliminate the insider trading problem.

I doubt you ever will eliminate insider trading. The amount of money that can be made is such that there will always be some people who will take that risk.

We need to bring more civil cases and there need to be more criminal prosecutions and we are well on our way to doing that at the current time. But once we get through this era of cases—and I really can't make a prediction as to when that will happen—it's not going to be enough to say, OK, we've solved the problem. It's going to have to be a continuing program over an extensive period of time because the amounts of money that can be made—and I tried to make this point earlier with the $3,000 investment that could turn into $430,000 overnight—the amount of money that can be made is so large that there will be people, whether they are young people or old people, who when they are confronted with that opportunity will decide that it is worth the risk. And the best that we can do is to continue to prosecute these cases, bring as many cases as we can bring, so that there will be people who will assess the risk and say that the risk is too great at the moment and I'm not going to take it.

Senator SASSER. I'm going to conclude with this, Mr. Chairman. My overriding concern here in this whole problem is that this business of corporate takeovers or hostile takeovers in which a great deal of money is made very rapidly and a great deal of debt is incurred very rapidly, I think it's a very unhealthy situation and it lends to this whole atmosphere of uncontrolled greed that I think contributed to the insider trading and I'm hopeful that we can do something about these takeover artists sometime in the near future, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Earlier this year, Chairman Shad said that he believed that additional shoes would fall by this summer in terms of other major

cases coming forward. Are there other major cases coming sometime later this year?

OTHER MAJOR CASES THIS YEAR

Mr. LYNCH. Well, since Chairman Shad made that statement we did bring the *Martin Siegel* case and the *Jefferies* case. I consider both of those cases to be major cases.

Will there be other cases? Sure there will be other cases. There is no question, given the number of investigations that are underway and the information that we have that we have gathered to date with the cooperating witnesses and with the subpoenas that we've issued, that some of the investigations that are underway will lead to further prosecutions. I'm sure that some of those cases will be major cases.

But I am not in the position now to put a timetable on those cases.

Mr. GIULIANI. I would have to state precisely the same thing, that there's no way to really predict. There is no doubt that there is an awful lot under investigation and we anticipate that there will be further cases, but there is no way to predict just when because the investigations always seem to take longer than when you start you believe they are going to take.

Senator RIEGLE. I'm wondering too the extent to which we may be moving into new areas. I don't want obviously to get into specific cases, but I don't want us to be any further behind the curve than we are in terms of trying to think about what kinds of legislative responses may be appropriate.

I'm wondering, as you go down these trails of evidence and as one disclosure sometimes leads to another, are we entering into any new areas of particularly large-scale difficulty that are not just more of the same but something that we ought to really start to pay attention to?

Do you see anything like that occurring in your investigative efforts, either of you?

Mr. LYNCH. Yes. I would have to say that we are seeing that. We started out with insider trading cases and the people who have decided to cooperate in those cases have pointed us at other violations, in my view equally serious violations of the law.

Given all the publicity that insider trading has received, I guess one would think that it's the most serious securities law violation that could occur. It is a very serious violation, but there are other violations that are being investigated now that, in my view, are equally serious.

They might not be as easy to understand as insider trading. I think insider trading has an immediate appeal to people. They understand the concept. They understand generally what it's all about and most people would agree that it's bad.

There are other violations of the law that I think are more sophisticated violations but equally serious.

Senator RIEGLE. What are some of the areas?

Mr. LYNCH. Well, I hate to get into this. Well, I can talk about——

Senator RIEGLE. Generically.

Mr. LYNCH. Well, I can talk about the *Jefferies* case where we talk about parking, where a person who owns securities decides to transfer them to another account, to another broker, so it appears that someone else owns the securities. Or someone simply has a nominee buy securities on their behalf, for whatever reason, whether to avoid the 13(d) requirements or for net capital purposes as in the *Jefferies* case, or perhaps for other reasons.

In my view, those kinds of violations are equally serious as insider trading. They are misleading the market as to who the actual owner of securities is and that can be very material information.

COLLUSION

Senator RIEGLE. How about collusion? Are you finding—some people are concerned that there may be a pattern where arbitrageurs, institutional investment managers, investment bankers, and corporate raiders, and others perhaps, act in concert in a kind of hidden conspiracy or a group effort to take, particularly in corporate takeovers, and you may in fact have something going on in that area simply by the fact that you have all these different parties coupling themselves together.

Is there a problem in this area or not?

[Witnesses consulting.]

Mr. GIULIANI. The reason we consulted is that there are areas under investigation that involve the question that you put to us. I think it might be better if we gave you a confidential response to that.

I think we can say publicly that those are areas of concern and areas that are under investigation, some of which may become public fairly soon have not yet. Therefore, if we could respond confidentially, I think that would be more appropriate.

Senator RIEGLE. I would prefer that. In fact, I think if you've got something going in that area probably it would be just as well that we find out about it when it becomes public rather than otherwise.

Well, that's very interesting to me because it has begun to appear from just a pattern of what we've seen so far that something is driving this very substantial increase in activity which you cited in your data and you've seen in your data, and these do not seem to be just isolated random events of a sophisticate thief mentality but rather something that's far more interconnected than that and I'm very interested in getting to the bottom of it if we can.

Now there was one other thing along that line I wanted to raise with you and that is I'm concerned about the fact that the *Dennis Levine* case sort of fell into our lap. I mean, it came on the basis of sort of a random tip, as I understand it, that might just as easily not have come in. Now if that's not so, correct the record. But my understanding is that in a sense that one we sort of got by good fortune, if you will, and that case in turn really started to topple a line of dominos and it seems to me that a number of investigations have come out of that.

If that's so, I ask myself the question, how many other things may there be that are going on by the use of sophisticated tech-

niques of hiding activities and reversing phone calls and things of this kind that, while we may have found this particular sort of nest of activity because of the good fortune of going down that track after that lead was developed, that there may be other things of this kind that may be escaping detection just as that escaped detection for so long.

Is that a problem we should worry about, Mr. Lynch?

Mr. LYNCH. Well, I think there's a lot of misinformation that's been floating around about the source of the *Dennis Levine* case. One would get the impression from reading some of the descriptions of the *Dennis Levine* case that someone came up to us and said, "Dennis Levine is trading on inside information and he's trading through Banklev Bahamas, go out and prosecute him."

What actually happened was that there was an anonymous letter sent to Merrill Lynch's headquarters in New York that pointed out that there was apparent insider trading activity in the Caracas, Venezuela office of Merrill Lynch. Merrill Lynch brought that anonymous letter to the attention of the SEC and we determined that the people in the Caracas office were actually following orders that were being placed in the New York office of Merrill Lynch, that there was a connection between New York and Caracas. And the New York Merrill Lynch representatives had as one of their major accounts Banklev Bahamas.

Now prior to the time that we had that tip, we knew that there was trading coming out of Banklev, suspicious trading coming out of Banklev. We had gone to Banklev on one occasion and requested information and they had determined not to provide that information. Obviously, Bahamas has secrecy laws and it's not simply like subpoenaing information from New York or LA. The SEC cannot issue a subpoena to the Bahamas and expect that a Bahamian bank is going to comply with that subpoena without question. In fact, we don't even have the statutory authority to issue that kind of subpoena.

So we got keyed into the particular investigation that led to Dennis Levine's prosecution as a result of that tip that came in. There's no question about that, but it wasn't the tip that Dennis Levine is trading on inside information. There was a lot of investigative work—I might say very good investigative work—that went on for a 9-month period before we finally learned that Dennis Levine was the person who was responsible for the Banklev trading.

Now I'm not going to tell you that there can't be improvements made in the surveillance system, the surveillance systems of either the exchanges or in the way that the SEC goes about dealing with surveillance referrals that we get from exchanges. I think we learn a lot as we go on.

Mr. Giuliani said before that I think all of us learned a lot about the extent of insider trading in the market. I have been with the Commission for 10 years, have worked on any number of insider trading cases, but I confess to you that I was shocked by some of the things that we learned from cooperating witnesses in our investigations. The extent of the problem is much greater than I had ever thought.

As a result of what we are learning now I think we need to refine our surveillance techniques. We need to refine the way we go about interreacting with the exchanges so that we are in a better position to police the markets.

But I just wanted to clear up the misimpression that somehow someone came to the SEC or came to the Justice Department and said, "Dennis Levine is your man."

Senator RIEGLE. Thank you.

The CHAIRMAN. Thank you, Senator Riegle.

Mr. Lynch, I want to follow up what Senator Riegle was asking about with respect to the investigations.

INCREASED INVESTIGATIONS

Can you give us an idea of how many more investigations are taking place and how they compare with the situations in the past? Is this an increase over your past activity?

Mr. GIULIANI. The answer is yes. The answer is there is certainly——

The CHAIRMAN. In both respects, in respect to both prosecution and the initial investigation by the SEC?

Mr. GIULIANI. There is an increase I'm sure in both. There's certainly an increase in my office.

Mr. LYNCH. There's an enormous increase in my office. I mentioned earlier that we have at least 20 professionals on the cases that have developed out of the *Levine/Boesky/Siegel* series of cases. In addition to that, we are stepping up our other investigations of insider trading and other types of related abuses. So we have many more people working on insider trading cases today than we did 1 year ago and I would anticipate that at least for the short-term future we will continue to put more people on cases.

The CHAIRMAN. Now in addition to the possible collapse of ethics which may or may not be the case, we do know that there's been an enormous increase in takeovers and you've indicated that that may well be one of the reasons for the huge increase in insider trading cases because that's where you can make the money and that's where the insiders move in.

Also, your technology has come on like gangbusters, as I understand it. Isn't that right?

Mr. LYNCH. Our surveillance systems are much better, without question, so there are more situations that turn up that lead to investigations than in the past.

The CHAIRMAN. Now 1986 was a pretty bad year for crooks on Wall Street. The SEC launched 312 enforcement actions forcing insider traders and market manipulators to cough up some $80 million in profits and pay some $60 million in penalties.

Do you have any sense as to whether the securities industry takes the law more seriously now? Do they take the law more seriously? Are cases you are now pursuing based on crimes permitted before this drama became publicized or are insiders still trading with as much oblivion of the law as the *Boesky, Levine* and *Siegel* cases suggest?

In other words, has the hanky-panky diminished, or do you think it's going on?

Mr. GIULIANI. I can't tell you, Senator, that it's stopped and I think, as Gary Lynch indicated before, it will probably never stop. I think that there's no doubt that a number of firms are taking all of this much more seriously. I think the level of cooperation is greater than it was in the past and even the extent to which voluntary disclosure of information happens is increasing.

The CHAIRMAN. So you think it's beginning to diminish?

Mr. GIULIANI. I believe it is and it's a belief more than a scientifically ascertainable fact. But I believe that it's beginning to diminish and I believe that the efforts of the SEC and the Justice Department and all the concern shown on the part of the Congress and others is beginning to get the attention of the financial community—not everyone and not as fast as we would like, but I think there's a lot of concern and some very legitimate attempts to try to self-regulate and legitimate attempts to try to clean up the problem. It doesn't extend to the entire financial community and there is still some that have to be dragged into this kicking and screaming, but by and large I think that there's a pretty vast change in attitude.

The CHAIRMAN. Mr. Giuliani, in a Reuters interview, you say that brokerage firms must spend more money on compliance. You've been quoted as saying that whatever they are spending they should double it, they should spend as much as maybe 10 percent if that's what it takes to make sure its employees understand the law.

Could you elaborate on your suggestion and, also, is compliance education really the problem? Do you think some brokerage firms in fact discourage compliance?

Mr. GIULIANI. I don't know that they discourage it and I don't think that compliance education and auditing is the sole answer to it. This is a very complex problem, but it's 1 of 20 or 30 things that have to be done and I think in the past, due to all the things that we've talked about, it was not given the kind of attention it should have been given.

The CHAIRMAN. Now you have on the books now a law that provides a penalty for failure to manage properly, isn't that right?

Mr. LYNCH. A civil case can be brought for——

The CHAIRMAN. Failure to supervise?

Mr. LYNCH [continuing]. For a firm's failure to supervise, that's correct.

The CHAIRMAN. And that's been used sometimes, has it not, or has it?

Mr. LYNCH. Yes, we have used it.

The CHAIRMAN. Now supposing we pass legislation providing for a specific fine for a firm. Some brokers tell me that that's exactly what they need so the firm itself knows it will have to pay a fine, it may be a very big fine, in the event somebody in their employ engages in insider trading.

Mr. GIULIANI. Mr. Chairman, there had been a question before when you were out to that effect and I indicated that I thought that legislation like that should be seriously considered, particularly if you built in the ability of the firm to demonstrate that it did everything that it could to comply and therefore had some exception to the application of the penalty. In other words, if the firm

could show that they've made a good faith effort to comply and been victimized by some errant employees, I would think then they could be relieved of the fine.

But if they can't make that showing, then I think it would be effective. And this is not very different than the legislation that you were very responsible for—the currency transaction reporting requirements. Due to the original legislation and some of the increases in the coverage and the penalties, I think that banks now take those requirements a lot more seriously. They have compliance programs, education programs, auditing programs. That's something they didn't have a decade ago.

I think that's the kind of thing that has to happen with many of these abuses that we're discussing. A very similar kind of thing has happened in the banks with regard to currency transaction reporting requirements that they were not taking very seriously a decade ago and, in my experience now, they take much more seriously and devote a lot of their resources to dealing with.

The CHAIRMAN. Senator Bond.

Senator SASSER. Would the Senator yield for a unanimous consent request?

Senator BOND. Yes.

Senator SASSER. Mr. Chairman, I'd like to ask unanimous consent that my statement be inserted in the record.

The CHAIRMAN. Without objection. And also a statement by Senator Dodd, an opening statement, will be inserted in the record at the beginning of the hearing.

Senator SASSER. I thank my friend from Missouri.

The CHAIRMAN. Senator Bond.

FIDUCIARY DUTY

Senator BOND. In your written material, Mr. Lynch, you said that insider trading generally refers, among other things, one element being a breach of fiduciary or a relationship of trust or confidence. The objective, as you stated in your testimony, of preventing insider trading was to assure investors that they were being treated fairly in the market.

Assume for a minute that a bystander on Wall Street overhears two people talking about a major takeover they're going to launch tomorrow. He has no relationship, no fiduciary duty. He's just there and he goes out and buys $3,000 worth of options way out of the market. A week later he's worth $480,000. Back in the heartland, I think that is about as discouraging to a potential investor in the stock market as if that had been a confidential employee or that person had been the rider of a herd on the street column.

What's the difference?

Mr. LYNCH. Well, in the case that you posit, if someone possesses inside information that they've received because it's simply fallen into their lap they are not violating a duty to any particular person by using that information.

I don't think there's much of an incentive for people who have that kind of valuable information to talk in a public place such that that person is going to overhear them. I'm not certain that the situation that you posit presents a real threat to the marketplace

because I can't imagine that it would occur in enough situations that we should be concerned as law enforcement authorities about regulating that particular situation.

And were we to go the step to say that anyone who comes into information, no matter where they get it, can't use that information, I worry that we might be introducing a lot of uncertainty into the process of making a trading decision.

I think that the criticism of the current insider trading laws for being unclear, that people don't know where they stand, that there are so many gray questions, I think those criticisms are overblown. I think the law is relatively clear now and certainly the people that we prosecuted know that they're violating the law. People don't pass money in attaché cases if they think they are engaging in perfectly appropriate conduct.

But were we to get to the point for the U.S. Government to say that anyone who comes into possession of information, no matter how they get it, can't use that information, I do worry that we would be creating uncertainty and creating gray areas.

Senator BOND. Mr. Giuliani, you said that the test was whether they were using it to defraud. Would something coming into the possession of a trader without specifically breaching a fiduciary duty—would that cause you to look for—is that not a badge of fraud to you or a violation of law? Do you have to find a fiduciary relationship?

Mr. GIULIANI. Certainly for a violation of 10(b)(5) you do. There has to be a violation of a duty or a confidential relationship of some kind. And I guess the analogy that I think of quickly is the difference between people who steal property and others who might find stolen property deposited on their doorstep and don't ask question as to where it all came from.

There may very well be something unethical and shady about what you've just described, but the person at least is not in a situation where they positively went about acquiring information or in a situation where they were being paid substantial amounts of money for keeping information confidential they then used for their own benefit.

And if any remedy were considered for that kind of conduct, I would think it would be more in the nature of a civil remedy having to return or disgorge profits rather than a criminal violation.

Mr. LYNCH. Senator Bond, if I could just respond again to your question, certainly if you had a situation where the trader overhearing the conversation between these two persons was in the same firm as those persons, then that trader has the same duty not to trade on the inside information.

I took your question to be a situation where the person overhearing the conversation has no relationship whatsoever with the companies involved, with the investment banking firms, with the law firms, or whatever—just a bystander on the street.

Senator BOND. One final thing I just want a brief comment from you on. You talked about other violations of the law and you set forth some which are very destructive to the confidence in the marketplace. There have been featured in major financial publications recently stories about securities firms which apparently have en-

gaged in a continuing course of conduct which would defraud the small investor, yet, as these publications point out, they still thrive. They still advertise. I have seen them advertising in some of the publications which condemn them as being consistent in those practices.

Do you lack statutory authority to take effective action against those?

Mr. LYNCH. Well, one story that you may be referring to appeared in a major magazine recently where it criticized the Commission for not taking action to shut down this particular firm. What it didn't point out or didn't point out as explicitly as it should have was that the Commission has already issued a bar order against the principal of that firm so that he would be out of the business for 2 years and has also barred the firm from engaging in underwriting for 2 years. But the D.C. Court of Appeals has stayed that order.

We may have our own views as to who is engaging in illegal conduct and who is not, but under our legal system a firm or a person associated with a firm is entitled to their day in court and we're litigating at the current time any number of enforcement actions against the people who have been featured in recent articles. But like any other litigant, we have to go through the court system if we want to put those people out of business or restrict their ability to do business.

Senator BOND. Thank you, Mr. Lynch.

The CHAIRMAN. Senator Riegle.

RISK ARBITRAGE

Senator RIEGLE. I want to ask both of you the question about the risk arbitrage and particularly as it relates to this pattern of cases that you've been developing and also this huge increase in hostile takeover activity that relates to it.

I'm wondering what each of you has learned about risk arbitrage as it relates to the pattern of activities that you've been focusing on and do either of you feel that perhaps risk arbitrageurs ought to be required to register with the Commission?

Mr. LYNCH. Well, most risk arbitrageurs are registered with the Commission because they are brokers or dealers. So at the current time I think we pick up the overwhelming majority of people who are engaged in the risk arbitrage business.

Senator RIEGLE. Those that aren't, should they be required to come on in, too?

Mr. LYNCH. It's something worth considering. I hadn't thought about it. I'm not certain that we're missing at the current time, any major players in the risk arbitrage business. I think most of them are registered as broker-dealers.

Senator RIEGLE. But I guess my concern would be that if we don't—I'm raising the question as to whether there may be others out there that are engaged in this activity that we may not even know are out there because we don't have a requirement to, in a sense, capture that activity.

I guess my question really is this. Is this activity significant enough as you're watching it play out in the kinds of cases that

you're seeing that if that were out there there would be a good public purpose served for us to be able to get a handle on that and to track it in some fashion?

Mr. LYNCH. Well, as I said, I think that's something that's worth considering. I think there would be perhaps a problem as to who you swept into the net. At the current time, most major risk arbitrageurs who are significant players in the market are registered as broker-dealers.

There are people who fancy themselves as amateur arbitrageurs who take small positions in securities that are the subject of takeovers. I certainly wouldn't think it would be worthwhile for the Federal Government to get reporting from all these little individual investors around the country who consider themselves amateur arbitrageurs.

But to the extent there are major players in the arbitrage business who aren't currently picked up under the regulatory framework now, I think it's worth considering whether or not they should be picked up.

Senator RIEGLE. Do you have anything to add to that?

Mr. GIULIANI. Senator, I don't know that I could tell you whether they should be registered or not but I think I can say that the business that they are engaged in is a business that has to be closely regulated and carefully watched because, in essence, they are speculating on takeovers. And the way you can best remove the risk from being a risk arbitrageur is to obtain inside information and that's just inherent in the nature of the work. That isn't to say that many people don't do it honorably, decently, and don't succumb to the temptation of removing the risk. But from the point of view of regulating the securities market, that has to be understood about the whole business of risk arbitrage and, therefore, there should also be considerations as to how they should function within a firm that is engaged in the business of advising and representing people in the takeover deals about which they are speculating and wanting to find out information about, or their colleagues in the risk arbitrage community are speculating about and attempting to remove the risk by obtaining information about it.

Those are all areas that I think are legitimate areas for concern for this committee and are matters that the financial institutions have to consider maybe more stringent internal regulations and if that doesn't work maybe it's an area where legislation is necessary.

Senator RIEGLE. Let me ask you one other thing. In the case of Ivan Boesky and Boyd Jefferies, they have agreed to cooperate and are cooperating, as I understand it. They are providing you any and all information that you've sought. Is that an accurate statement?

Mr. LYNCH. That's correct.

Mr. GIULIANI. That's correct.

Senator RIEGLE. Now I take it that other people where you've handed down indictments have taken the other avenue and they are basically not cooperating. Is that correct?

Mr. GIULIANI. Sure. There are examples of both. Beyond Mr. Boesky and Mr. Jefferies, there are people who are also cooperating and there are individuals who have said that they are not guilty and we'll have to go to trial.

Senator RIEGLE. In the instance of those that have agreed to cooperate, has that been of great help to you and is that something that will be weighed in their favor at the other end when it comes time for final decisions on prison terms or whatever?

COOPERATION WITH INVESTIGATORS

Mr. GIULIANI. I'm glad that you asked that question, Senator, because I think it's a very important aspect of all this and it's one of the things that I think has to have been inadvertence, but somehow in the things that I've been saying and the things that Gary Lynch has been saying we have not talked about what is probably the single most important factor in investigating and bringing civil cases and bringing criminal cases against people engaged in securities fraud and insider trading, and that's cooperation from the people who are involved.

All the best technological surveillance in the world is not going to tell you in the kind of detail you need to know it in order to prove it in court about what's going on in the middle of an insider trading scheme or a securities fraud scheme unless you have some witnesses who can explain it to a court and to a jury. And by and large, that means people on the inside because people engaged in schemes like this keep the scheme confidential and they go to great efforts to conceal it. So you have to, in investigating these things, essentially convince people to cooperate with you.

Now one of the ways to do that, obviously, is to offer them some benefits for cooperating and it seems to me that the way to do that is to balance the benefits that they get against the penalties that they also have to incur. A person who cooperates should not be treated, obviously, as harshly as someone who doesn't. Otherwise, no one is going to cooperate.

That doesn't mean that they should get away with it completely and, therefore, what we try to do where someone cooperates is expose that person to criminal penalties with the recognition that a judge is going to take their cooperation into consideration and give them a reduced penalty and expose them to a full range of civil penalties so that they are punished but there are also some definable benefits.

Now Dennis Levine cooperated with the SEC and he cooperated with the Department of Justice and my office and he was sentenced about 1 month ago. The judge who sentenced him I think made a very clear statement of just exactly the benefit that he gave Dennis Levine for cooperating. He said that if Dennis Levine had not cooperated he would have given him between 5 and 10 years in prison. As a result of having reviewed all of the crimes that Levine committed, as well as the full cooperation that he had given to the Commission and to the U.S. Government, he gave him a 2-year prison sentence.

He didn't relieve him of the obligation and the necessity of going to prison, but he reduced that sentence substantially because he cooperated.

Now you might argue with the number, but I think that's the concept. That's the concept that has to be followed. And by and large, those decisions then have to be left to judges who can inde-

pendently evaluate the crimes on the one hand against the benefits that come from the person's cooperation with the Government.

In Mr. Levine's case, he revealed the activities of very substantial individuals who were engaged in fraud. Every single person about whom he gave us information it turned out to be true. I think all of them have now been convicted based on his cooperation. If not all of them, almost all of them. And if Dennis Levine had not cooperated, much of the fraud that has now been revealed and stopped would still be going on as we sit here talking today.

So you have to give benefits for that. It should not mean, however, that they escape going to prison altogether and I think it worked out, if not precisely and exactly the way we would all like to see it worked out, about right in the *Dennis Levine* case.

Senator RIEGLE. Do you want to add anything, Mr. Lynch?

Mr. LYNCH. The only thing I would add I guess is to stress the importance of cooperating witnesses in insider trading investigations.

Generally, you have to show that a conversation occurred between one person and another person. If both of those people deny ever having the conversation, it's obviously going to make for a difficult piece of litigation. To the extent that you have one of the parties admitting the conversation, obviously it's extremely helpful.

We would not be where we are today had we not made the determination to reach a settlement agreement with Dennis Levine and reach a settlement agreement with Mr. Boesky. If we had not settled with Mr. Boesky, it would be 1990 or 1991 and we would still be litigating with Mr. Boesky and all the revelations that have come out now would be unknown to the country and to Congress.

As it is now, we have exposed many of the facts that Mr. Boesky brought to our attention and I think we're on our way toward cleaning up the problem.

Senator RIEGLE. It seems to me the strong message that comes from that is that those people that have been discovered as having been involved in these activities, one way that they can not only serve their own interest but I think at this stage serve the public interest is to come clean with the rest of the information that they have; if there are other people involved, to indicate who they are, and the sooner that everybody is identified and removed from this business that's been involved this way, the better for everybody. And I would hope that nobody out there would have the misguided sense that if they conceal information on the margin that somehow that that is a sufficient answer because clearly it is not. And it's important that we proceed and get the rest of this work done I think.

I thank the witnesses and I thank the chairman.

The CHAIRMAN. Mr. Lynch, the Boesky arbitrage fund, was that registered as a broker-dealer?

Mr. LYNCH. Yes, it was. He had two registered broker-dealers, Seemala Corp. and I.F.B. managing partners.

CHINESE WALL

The CHAIRMAN. I want to ask you about the Chinese Wall. Mr. Lynch, you said it would be possible to construct such a wall that would successfully protect the securities firm from the arbitrage department. Now I doubt that and many people have said that you can't do it. There's just too much temptation. If you work for the same firm the information is going to find its way back no matter how high the wall is or no matter how thick it is.

Why wouldn't it be sensible to require that they be separated just as we separate banking from retailing or try to? Why shouldn't we separate arbitrage by law?

Mr. LYNCH. You could do that but I'm not certain that we have seen sufficient abuses yet and maybe we'll see those abuses in the coming months——

The CHAIRMAN. We've seen some pretty good ones.

Mr. LYNCH. Well, people in the investment banking section of a firm have incentives to leak information to arbitrageurs anyway, whether or not they have an arbitrage section within the firm. It's not only the existence of an arbitrage group within an investment banking firm that gives some incentive to keying in other arbitrageurs on a deal that may be coming down the pike. Yes, perhaps you could eliminate those situations where it may have occurred in the past and we certainly know, based on Mr. Siegel's cooperation, that he believes anyway that it occurred with respect to Kidder Peabody and Goldman Sachs and we know in the case of First Boston where the Commission brought an action that there was a breakdown in the Chinese Wall procedures.

The CHAIRMAN. In case after case after case, the Chinese Wall is a phony, it's a fake, it doesn't work, there's too much temptation to go back and forth, it's in the same firm, and therefore if you want to really get effective insulation, separate them.

Mr. LYNCH. But firms don't arbitrage deals that they're working on. There may be a rare firm or two that will take the risk of trying to arbitrage a deal that they're working on, but for the most part, once the firm knows that they've been retained by a client to make a bid for another company, that firm will not take a position in the securities of the target company.

The problems that we've seen have either been because there's been an isolated case like in First Boston where someone crossed over the line or there's a swapping arrangement, in essence where the arbitrage groups in two particular firms decide it's in their interest to swap information about what's going on in their investment banking groups.

I'm not here to say that Chinese Walls are the most wonderful procedure in the world, but I think that perhaps this should be given further examination before everyone rushes to the conclusion that we need to eliminate arbitrage activity by any firm——

The CHAIRMAN. Well, I'll tell you one thing this committee operates on and the Senate as a whole and the House—we don't rush, unfortunately. It takes a long time.

Mr. Giuliani, on February 24, Mr. Donald Merham, the chairman and CEO of the Paine-Webber Group, testified before this committee—he said; "Insider trading abuses on Wall Street are more than

mere aberrations. At least in the takeover area the abuse of inside information has grown systemic and must be stopped." I'd like to ask you if you agree with Mr. Merham that insider trading in the takeover area is now systemic and, if so, do you have any recommendations for legislative changes we can make that will help cure this systemic problem?

Mr. GIULIANI. Well, I certainly agree that it's an extensive problem and I really wouldn't quarrel with the description of it as a systemic problem, given the number of cases that have now resulted in convictions, and I think that there are a number of areas that the Congress should look into in terms of legislation. I don't know that I'm in a position to give you firm recommendations on what the final conclusions should be, but some of the things that I mentioned before—increasing the criminal penalties, decreasing the window under 13(d) I think can be very effective. I think, along with Gary Lynch, what I would suggest is that you take a good look at the arbitrage function and the conflict that that might or might not create with regard to the rest of the investment banking functions of a firm when they get involved in takeovers.

In preparing for this testimony, one of the people working on these cases said that a more accurate description of a Chinese Wall, they may have picked the wrong country to describe it—a Swiss cheese wall might be a better description of it.

The CHAIRMAN. Well, that's my impression.

Mr. GIULIANI. But I think that's something, whether it's a matter of self-regulation or legislation, that's something I think that's a sensitive question.

I do know that from my own personal point of view, if I had the responsibility of running an investment firm, I would be pretty nervous having the two functions operating under the same roof because the temptations are so great. Even the temptation of mistakes being made which later could be misunderstood and civil liability could be imposed on you because there is a tension between those two functions and an inherent conflict.

So those are things I think Congress has to look at and then there are a whole host of other things.

GOLDMAN-SACHS CASE

The CHAIRMAN. That's very helpful. Let me ask you about the *Goldman-Sachs* case. Goldman-Sachs, seems to be rallying particularly strongly around its partner charged with arbitrage trading, Robert Freeman, whom you arrested on February 12 this year. In fact, that particular case seems to be something like a cause celebre.

What can you tell us about the events leading up to Mr. Freeman's arrest? How do you explain the publicity and Wall Street support for Goldman-Sachs defense of Mr. Freeman?

Mr. GIULIANI. Well, there isn't much I can appropriately comment on as to the nature of the case and Mr. Freeman and Goldman-Sachs have every right to contest the charges and to plead not guilty and to go to trial. And until and unless there's a verdict to the contrary, they have to be presumed to be not guilty.

As to the arrest of Mr. Freeman and his codefendants, that arrest was carried out applying the same principles that have been applied to other white collar criminal prosecutions. It is not often noted that Dennis Levine was arrested almost 1 year before any of those defendants were arrested. Several other defendants in the group of cases that are listed here in this chart were arrested long before Mr. Freeman was arrested, applying the same principles to them that were applied to Mr. Freeman and to Mr. Wigton and to Mr. Tabor.

After the arrest, it was popularly stated that they were the first people that had ever been arrested in insider trading cases. That is not true. They weren't the first. But that, for some reason, I think has become something that just gets repeated and said. They were treated in the same way that significant numbers of other people were treated who were arrested by the U.S. Postal Authorities. They weren't mistreated. They were arrested applying the normal procedures of the U.S. Postal Authorities and I think their complaint really is that they weren't given special treatment.

The CHAIRMAN. That's very helpful.

One other question before I yield to Senator Bond. Mr. Lynch, you point to some helpful treaties with other countries and indicate that's one of the reasons why you've been more successful in your investigations and in Mr. Giuliani's prosecutions.

Clearly, however, there remain serious problems in getting needed information across borders. On a scale of 1 to 10, with 10 being the best, how far have we progressed in establishing the kind of international information network necessary for sound securities law enforcement?

Mr. LYNCH. I guess we're up to 3 or 4. We certainly have a ways to go and——

The CHAIRMAN. And a few years ago we were at——

Mr. LYNCH. We were at .5, if there. We have succeeded over the last 3 or 4 years in convincing other governments that this is a problem that they should be concerned with. Three or 4 years ago, we had trouble finding other countries with active securities markets that were interested in working with us toward developing a formal framework for cooperation.

There's been a reversal now of that and other countries are very interested in putting together some kind of regulatory framework so we can regularly exchange information. I do think there's been a change of attitude that's really happened in the last 2 to 3 years.

The CHAIRMAN. Senator Bond.

Senator BOND. To follow up on the chairman's question, is there anything that Congress could do to provide more resources, a better framework for you, in dealing with those overseas trading activities which appear to be a substantial cause for concern, or is it simply negotiating treaties and working out international agreements to provide information and even return defendants?

Mr. LYNCH. Well, whenever an investigation requires us to go to another country to get information, it becomes that much more extensive and takes that much longer, so certainly more people. We've touched upon that theme before today. We certainly can use the people that have been requested for the SEC in our recent budget request.

Beyond that, I do think that we certainly need to intensify our discussions with other governments. Given all that we're doing, it's a struggle to try to find the time to sit down around a table and negotiate those treaties or memoranda of understanding, but certainly the interest is there.

I think one thing that we ought to think about—I guess think about in the near future—when we negotiate a treaty with another country, one of the things that we are starting to look for is the ability of that other country to compel the production of information within that country.

At the current time, if another government comes to us at the SEC and wants us to get information for them within the United States, we can do that if we can gather that information on a voluntary basis. But we don't have the authority to compel information on behalf of another government.

I think one of the things that we need to think about in the United States is giving the SEC the authority, if there is a lawful investigation in another country and if we have some sort of reciprocal relationship that we've negotiated with that other country, to help them gather the information, even if it is through the issuance of a subpoena to gather that kind of information, if they would be prepared to do the same thing for us in their country.

Senator BOND. One final item I wanted to raise with you. You said because it is relatively simple to file a 13(d) we could narrow that window down from 10 days down to 2 days.

What would be wrong with saying that once you hit 5 percent you need to file before you go beyond 6 percent? Certainly, they can get those 13(d) filings, it's not a real surprise to them when they cross 5 percent.

The CHAIRMAN. Would the Senator from Missouri yield for a slight amendment on that question?

Senator BOND. Yes.

The CHAIRMAN. What would be wrong with providing that before you get 5 percent or 3 percent, you file prenotification——

Mr. LYNCH. Well, the difference would be one share of stock, whether it's 4.99 or——

Senator BOND. I accept the chairman's amendment. I think the same question remains.

The CHAIRMAN. That's right.

Mr. LYNCH. On this I can only state my personal view and my personal view is that there would be nothing wrong with that, that someone wouldn't be disadvantaged to that great an extent if you simply said that once you got to a certain level you couldn't buy any additional shares until you filed a disclosure document with the Commission.

Senator BOND. Thank you, Mr. Chairman.

The CHAIRMAN. I'd just like to ask one question that's just been suggested to me. I won't ask this question of Mr. Lynch since he is still rumored to be under consideration for the chairmanship of the Securities and Exchange Commission and he's working with others who are also reported to be under consideration.

Mr. Giuliani, what kind of person do you think should be appointed as chairman of the SEC? [Laughter.]

The CHAIRMAN. You can ignore the fact that you're sitting next to a potential candidate.

Senator BOND. Would the chairman yield?

The CHAIRMAN. Yes.

Senator BOND. I believe that Mr. Giuliani has been suggested also.

The CHAIRMAN. He has but he's turned it down. That's why I asked him.

Mr. GIULIANI. I think that it really is a crucial time for the selection of someone to be chairman of the SEC because the SEC is probably going to go through the most important aspect of its whole history, and I think someone with a strong background in enforcement that understands the nature of the problems and can step in and just continue the fine work that the SEC has been doing would be the kind of person that I would look to, someone who understands the enforcement network of the SEC and how it can operate and how it can continue and someone who brings immediate confidence to the American public that the investigations are going to be followed to their fullest extent, that there isn't going to be the slightest bit of hesitation to take the investigations to the full extent that's required.

The CHAIRMAN. Thank you, Mr. Giuliani.

I want to thank both you gentlemen. You've been excellent. Your testimony has been most helpful and enlightening.

The committee will stand adjourned.

[Whereupon, at 12:35 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

72-963 O - 87 - 4

A Study

By

The Office of the Chief Economist
Securities and Exchange Commission
450 5th Street, N.W.

February 24, 1987

Stock Trading Before the Announcement of Tender Offers:
Insider Trading or Market Anticipation?

The views expressed herein are those of the Office of the Chief Economist only. The Commission has expressed no view on this study.

Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation?

Persons to Contact: Annette B. Poulsen (202) 272-7104
Gregg A. Jarrell (University of Rochester)

I. Introduction

Recent insider trading actions by the SEC against Dennis Levine, Ivan Boesky, and others have raised several important questions about the effects of insider trading on pre-takeover bid increases in stock prices and surges in trading volumes.[1] These well-publicized cases involve illegal trading in takeover targets based on non-public information about impending bids. Press accounts reveal enormous profits to inside traders. In addition, press accounts suggest that pre-bid market activity in target stocks verifies the existence of widespread insider trading.[2] In our research, however, we find that there are several readily identifiable factors influencing pre-bid trading and that pre-bid trading is not necessarily an accurate indicator of insider trading. While the ultimate source of pre-bid trading may be illegal information, trading in a stock once there is some indication that a firm is "in play" cannot necessarily be attributed to illegal trading.

It is apparent that stock prices and trading volumes of targets increase during the weeks immediately preceding public takeover bids. Several academic studies measure stock price activity preceding mergers and takeovers bids made between 1962 and 1980.[3] They report that stock prices begin to move upwards in anticipation of bids as early as two weeks before formal

announcement. They also show that about one-half of the total capital appreciation is accounted for by the close of trading the day before the formal bid. Although the researchers themselves do not generally ascribe these runups to widespread illegal activity, other commentators consider this to be direct evidence of insider trading.

Many argue that the opportunity to make large profits by conduct that is difficult to detect make it sensible to attribute this pre-bid market activity to trading by insiders, tippees, and those who imitate their behavior. The SEC's enforcement actions against Boesky, Levine, and others, while dispelling the notion that insider trading prohibitions are unenforceable, have increased the discussion of the possibility of pervasive insider trading. Newspaper stories are replete with general condemnations of Wall Street's information arbitragers, reflecting a view that legitimate speculation based on sophisticated analyses of public information is overwhelmed by illegitimate trading on non-public information.

Our study attempts to shed additional light on how the market for information operates to anticipate tender offers. We examine pre-bid market activity (daily stock returns and trading volume) over 172 tender offers from 1981 to 1985, and present improved statistical measures of runup in stock prices and volume surges. In specific, we examine how several readily observable characteristics of the takeover bid affect pre-bid market activity. These characteristics include the amount of pre-bid

speculation in the media, the foothold acquisition of the bidder and whether the bid is friendly or hostile. Presumably, illegal insider trading would not be dependent on these factors. If runup and volume surges were due primarily to illegal trading, then bid characteristics should not significantly influence pre-bid trading activity.

We summarize here our empirical results:

Based on 172 successful tender offers between 1981 and 1985, runup in stock prices is 38.8 percent of the total eventual control premium by the close of trading the day before the offer announcement. The runup index measures 27.6 percent as of two days before the announcement and 22.7 percent three days before the announcement.

Cumulative abnormal returns before the announcement are significantly different from zero as early as 17 trading days before the announcement.

About one-third of pre-bid market activity can be attributed to takeover speculation in the media. In bids with no rumors reported in the press, the runup index is only 32.7 percent one day before the announcement (19.1 percent two days before), as opposed to 50.3 percent (43.5 percent two days before) in those cases with reported rumors.

Foothold acquisitions by the bidder significantly affect pre-bid market activity. Runup as of day(-1) is 26.5 percent (10.2 percent on day(-2)) over 31 cases with average footholds of 2.56 percent, compared to 47.7 percent (40.2 percent on day(-2)) over the 32 cases with average footholds of 21.7 percent.

Friendly, negotiated takeovers have more pre-bid runup than hostile takeovers (47.1 percent versus 35.3 percent one day before the bid) when foothold acquisitions of the bidder are held constant at zero.

Average trading volume increases about 10 days before the announcement. Volume surges to almost 20 times normal daily volume on the announcement. On the day before the announcement, it is 5 times normal, on days(-2) and (-3), it is 3 times normal.

II. Insider Trading and Pre-Bid Market Activity

A. Insider Trading versus Legitimate Anticipation of Future Events

Illegal insider trading, as discussed here, refers to the restrictions imposed on insiders by Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 and Rules 10b-5 and 14e-3 thereunder. Trading on inside information, in which the trader has material nonpublic information concerning some future event, is very different from legitimate anticipation of that event. Public policy does not condemn market speculation in anticipation of important corporate announcements, such as those concerning takeovers, mergers, or other corporate business. For specialists in the analysis of corporate and economic information, the private returns from predicting future corporate events exceed the private costs. Legitimate research gives some traders informational advantages and their earnings serve as compensation for their efforts.[4]

Basic economics guarantees that considerable resources will be devoted to information analysis with respect to potential corporate control transactions. The prospect of huge takeover premiums and the many kinds of clues legally available to skillful specialists assures us of an active market for information on prospective takeover targets.[5] This market should create the runups in stock price and volume surges we observe.[6] Because the market for information is not perfect, there may be cases in which the anticipatory market activity is not followed

by a takeover. However, we consider here only those cases in which a tender offer was made.

Most economists defend legal investment analysis and believe that pre-bid market activity is inevitable. The trading is beneficial in that it makes capital markets more efficient. It aligns actual stock prices with their theoretically correct values, improving the allocation of scarce capital between competing uses. The actions of arbitragers, both before and after a takeover bid, provide considerable value to the market. In a recent Wall Street Journal article, Professor Michael Jensen of Harvard University and the University of Rochester noted some of the roles served by arbitragers after the bid is made:

> [Arbitragers] help direct resources to their highest-valued use. In doing so, the arbs provide three critically important services: 1) they help value alternative offers (including the plans of target management), 2) they provide risk-bearing services for investors who do not wish to bear the great uncertainty that occurs between the announcement and final outcome of a takeover bid or restructuring, and 3) they help resolve the collective action or free-rider problems of small, diffuse shareholders who cannot organize to negotiate directly with competing bidders for the target firm. (December 3, 1986, p. 26.)

B. Information Sources for Legitimate Trading

There are many sources of information on which trading in anticipation of a takeover may be based besides inside information. Particularly important is the Schedule 13D requirement of the Williams Act, which directs acquirers of more than five percent of a firm's equity to file a Schedule 13D reporting the acquisition within ten days of crossing this threshold.[7] This mandatory filing requires the purchaser to

disclose the reasons for the purchase, specifically whether or not the purchaser intends to seek control. Once the original Schedule 13D has been filed, the acquirer is obliged to file an amendment to reveal any important changes in intent (say, a change from "passive investor" to "investor seeking control"). Several studies show that 13D filings cause significant increases in the target stock prices and surges in trading volume, particularly when the filer discloses takeover-type intentions.[8]

In addition to mandated disclosures, "street talk" can affect pre-bid market activity in takeover stocks. While some street talk might originate improperly from inside information, objective observers of the sleuthing done by professional traders, arbitragers, "shark watchers" and Wall Street reporters point to numerous sources of information:

> [A]n army of traders, arbitragers and stock analysts is quick to spot unusual activity of corporate executives, the calling and canceling of meetings and other seemingly insignificant corporate developments that might give a clue to an upcoming major development.... Experts closely monitor such things as which brokerage firm is doing the heaviest buying and selling of a particular stock. Does the firm have a relationship with a known corporate raider? Is the buyer bidding up the price of a stock, indicating that he is anxious to get the shares in a hurry? (New York Times, August 12, 1986, p. D8.)

> [I]t's not hard for all sorts of people to deduce that takeover action is about to occur in a stock. Computers are a big help here. Accumulation is instant news; so is unusual volume. Connected by a national network of direct phone lines, smart traders ... talk to one another and to brokers constantly.... When investment bankers are hired, they frequently publish an internal memo that places their client corporation on a restricted list, to prevent conflicts of interest in trading and research recommendations. A company's name appearing a restricted list often is all the

> information needed by shrewd investors. (Forbes Magazine, February 10, 1986, p. 33.)

> [Arbitrager] Mulheren says his main sources are professional traders like himself, who make their living taking the pulse of the market and spotting unusual trading patterns. From the rim of [his] 10-person trading desk, Mulheren has access to about 170 trading wires that provide direct feeds into the major stock and commodity exchanges as well as a network of multinational brokers and securities firms. (WSJ, July 28, 1986, p. 1.)

Arbitragers use the knowledge that takeovers often come in "waves" with targets clustered somewhat by industry classification, as deregulation and other economic forces cause common adjustments in firms of common characteristics. Also, firm-specific knowledge, such as the impending demise of tight family control or internal disputes among managerial factions, often fuels legitimate takeover speculation. Finally, publicly available information disclosing large stock acquisitions and newspaper stories speculating on future takeovers can be important causes of pre-bid market activity, quite independent of illegal insider trading.

III. Research Design

Our study investigates how this market for information operates to anticipate tender offers. We examine pre-bid market activity (daily stock returns and trading volume) over 172 tender offers from 1981 to 1985, and present statistical measures of runup in stock prices and volume surges based on 1980s data. We introduce an index to measure runup, which expresses stock returns over various intervals preceding the formal bid as a percent of the total stock return attributable to the bid.

Trading volume around the tender offer is compared to a "standardized" volume measured before anticipation of a bid.

Our sample is drawn from OCE's study of tender offers from 1981 through 1984. (OCE, 1985.) We limit ourselves to only target firms that are listed on a major exchange and supplement these firms with tender offer targets in 1985. All offers are cash offers and are "successful" in the sense that at least some shares were purchased by the bidder. Appendix A lists our sample of firms that were targets of tender offers.

Data on stock returns are obtained from the Daily Excess Stock Returns File provided by the Center for Research in Securities Prices (CRSP). This file contains the daily returns for stocks in excess of the daily returns on a portfolio of securities with similar risk. These excess returns are more accurate than those obtained from a standard market model because the index to which the individual security is compared more nearly represents the characteristics of that security than does the overall market index.

For each firm, we obtain a time series of returns around the announcement dates. These returns provide information on stock price runup in the period before the announcement of a tender offer. Once we have obtained the returns for the individual firms in our sample, we find average excess returns over the portfolios of interest. Cumulative abnormal returns are found by summing the daily returns over the days of interest for the

individual firms and then averaging across the various portfolios.

In addition to stock returns data, we obtain data on daily trading volume from the Investment Statistical Listing (ISL) tapes provided by Interactive Data Services. We examine the daily volume of shares traded around the announcement of the tender offer to determine if there is unusual activity before the public announcement of a takeover. We compare the volume around the takeover bid to a "clean" period (from 170 days to 71 days before the announcement) in which no takeover news should have affected trading. We find the average daily volume for each firm over this period. The ratio of daily volume in the takeover announcement period to the average "clean" volume for each firm is determined. These standardized volumes are averaged over the portfolios of interest.

If the volume for a firm was equal to zero on any given day, the daily volume is set to a missing value and is not used in computing the average. This is appropriate because zero trades primarily result from stopped trading rather than from a lack of interest in the security, especially in these exchange-listed firms. To use zero would bias the average volume towards zero.

The most significant improvement in measuring pre-bid market activity comes from our use of the Dow Jones News Service, which covers all news releases on the Dow Jones News Service ticker or in the Wall Street Journal (WSJ).[9] Using these sources, we collect news on corporate-control events for each target firm

during an extended period (at least one year) preceding the takeover bid. These news sources allow us to correct a weakness common to all event studies of this subject. These earlier studies use the date of the formal WSJ announcement to define the end of the pre-bid period. While this is appropriate for some purposes, the formal announcement date often comes after widespread circulation of takeover-related news stories. Thus, studies that measure runup before the formal bid will exaggerate the degree of anticipatory market activity. Instead, we measure market activity in relation to the first day on which the target firm could be said to be "in play." In practice, this is usually the day of a Schedule 13D filing having significant implications for corporate control. This departure results in earlier event dates for 70 of the 172 cases, and significantly reduces the magnitude of our runup index.

We examine how three specific factors affect the magnitude of runup. These are intended to be rough proxies for the extent of legitimate pre-bid market activity. The first factor is the presence of any speculation in the media about control-related events. Using the Dow Jones News Service, we separate the takeovers into two groups, depending on whether or not takeover-related news (not complete enough to put the firm into play, according to our definition) about the target was publicized in the year preceding the formal bids. Comparing these two groups shows the striking effect that public speculation has on pre-bid activity. Speculation in the press increases the magnitude of

pre-bid runups in stock prices by roughly one-third, although the remaining "quiet" cases still exhibit significant runup.

The second factor is the acquisition of a "foothold" block by the prospective bidder, often accomplished before a formal bid is made. The foothold is usually purchased at prices lower than the eventual offer. This acquisition lowers the ultimate cost of the takeover and gives the bidder more voting power in the event of a proxy fight. All exchange trades are announced quickly and arbitragers report that unusual buying activity is an important clue in trying to predict future takeover targets. We measure the foothold acquisition of the bidder for each tender offer in our sample and show that the size of the foothold apparently affects positively the amount of pre-bid trading activity.

The third factor is whether the tender offer is a hostile contest or a friendly, negotiated deal. For our purposes here, a case is defined as hostile or friendly according to how the target firm was put "into play." If the initial bid is contested by the target, then the case is defined as hostile regardless of whether the ultimately successful bid was negotiated and agreed to by the target's board of directors. It may be that takeovers which are friendly from beginning to end are similar to negotiated mergers. This leads us to make the distinction here between "merger-like" tender offers and hostile control battles.

It is our premise that these three factors should explain differences in runup across cases in the absence of illegal inside trading. If, alternatively, illegal inside information is

the dominant cause of runup, then these factors should not explain much of the variation across cases. Access to illegal information should depend on other factors, some of which we can observe after the fact (use of law or investment banking firms that are later identified as sources of information for inside traders) and some we cannot observe (undetected inside traders). Rather than attempt the difficult task of directly testing for insider trading, we show how much of the variation in stock price runup across cases can be accounted for by these three factors.

Our results generally show that the three factors have considerable explanatory power, suggesting that there is an active legitimate market for information that causes pre-bid activity in the stock of prospective takeover targets. This conclusion must be qualified to the extent that these three factors can be interpreted to measure, either directly or coincidentally, the extent of illegal insider trading.

Most susceptible to contrary interpretation is the presence of media speculation. News stories could have originated from the spread of illegal inside information. We investigated this possibility by checking the extent of pre-bid media speculation for the takeover cases that involved illegal activity by Levine and his associates. We do not find an unusual amount of media speculation for these Levine cases. Thus, at least in these cases, the presence of media reports is not a very good indicator of illegal behavior by insiders.[10]

We turn now to a more detailed discussion of how we define the "news-adjusted" event date using the Dow Jones News Service and explain how we construct the three determinants of pre-bid market activity.

A. The News-Adjusted (NA) Date

The academic finance literature generally uses the formal announcement of a takeover bid in the Wall Street Journal as the announcement date. (This date is what we refer to as the "finance date.") To guard against exaggerating pre-bid market activity, we refine the definition of the public announcement date of the takeover. This leads us to choose dates that are earlier for many cases than the date of (or the day before) the WSJ announcement of the formal bid.[11] We call this the "news-adjusted" date, or "NA date". To use the parlance of Wall Street, it is intended to be the day that the target firm was put "in play."

Specifically, the NA date is the earlier of:

(1) the (day before the) formal WSJ announcement date,

(2) the public disclosure (usually over the Dow Jones Ticker) of a Schedule 13D filing with a possible intention to seek a change of control, or

(3) the public announcement of merger talks naming the target firm.

A further requirement for dates (2) or (3) to be used is that they must be followed closely by a formal bid, or by sustained speculation of a takeover that materializes in a formal

bid. For the 172 cases during 1981-85 for which we have detailed information from the Dow Jones Ticker and WSJ stories, 70 have NA dates earlier than the formal WSJ (or "finance") announcement date. (That is, we rely on criteria (2) and (3) for 70 of the cases, and on criterion (1) for the other 102.)

B. Secret versus Rumored Takeovers

Each takeover is categorized as either 'secret' or 'rumored' by searching all news releases reported by the Dow Jones News Service during the one year preceding the NA date. There are 69 cases of rumored takeovers and 103 secret bids. The presence of any one of the following five kinds of news stories results in the case being categorized as rumored:

(1) rumored merger or takeover talks without confirmation by parties involved;

(2) 13D filings or other substantial holdings reported without announcement of attempts at control changes;

(3) formal merger or takeover negotiations which had been halted or terminated;

(4) significant stock repurchases within the previous year with potential control impact; or

(5) any story that would have qualified as denoting an NA date except for a six month or longer delay between that date and the formal WSJ announcement.

Thus, rumored takeover cases are those that had takeover-related news stories preceding the formal WSJ announcement that did not qualify as NA dates. If the first takeover-related story

is a report of a new 13D filing with a stated intention to take control, for example, then this would be considered the NA date and the case would be denoted as secret. On the other hand, if the first takeover-related story is one of the kinds just described, then the later, more formal news release would define the NA date, and the case would be denoted as rumored.

Note that in designating our cases as either secret or rumored we rely on only two news sources -- the Dow Jones Ticker and the WSJ. We have not perfectly delineated these two groups -- many of our takeovers designated as "secret" probably were subject to speculation by investors that they would be a target. However, even our imperfect classification scheme does provide information about comparative trading activity. The evidence shows there is substantially less runup in those cases we can designate as secret. We expect that if we could successfully classify those firms which were rumored to be takeover targets using all publicly available news sources, the runup could be reduced even more dramatically.

C. Foothold Acquisitions of Bidders

We determine percent holdings of the initial bidder in the target firm at the time of the bid in each of the 172 offers included in our sample and relate them to pre-bid trading activity. These holdings are obtained from the Schedule 14D-1 filings made by the bidder detailing the terms of the offer (or Schedule 13E-4 in the case of an issuer self-tender offer.) The

Williams Act requires the bidder to reveal his holdings of the target in these filings.

The mean foothold position for the bidder at the time of the bid was 7.4 percent. In 72 of the offers, the bidder held no shares in the target firm at the time of the offer. The mean foothold across the other 100 target firms was 12.7 percent, ranging from a low of one-thousandth of one percent to a high of 50.5 percent.

We use foothold data as an indicator of observable acquisitions by the bidder immediately preceding the bid. Unfortunately, these acquisition data are only approximations of that trading activity. One problem in using these data is that the footholds are measured at the time of the formal bid. However, we measure our pre-bid trading activity as of the news-adjusted date. Thus, our foothold data may exceed actual holdings at the time of the NA date.

A more substantial problem is that the level of holdings at the time of the formal bid does not indicate when those holdings were accumulated. Unusual pre-bid trading activity should result from recently acquired positions; static, long-term positions do not provide any new information to market participants. If we could readily determine when these positions were acquired, we could obtain better measures of the relation between recent acquisitions by the bidder and general pre-bid trading activity. However, the level of footholds should be a reasonable approximation to achieving this goal.

D. Hostile versus Friendly Tender Offers

We also determine whether the tender offer is hostile or friendly. The offer is considered to be hostile if target management expresses opposition to the bid. Opposition may take several forms -- defensive stock repurchases, litigation, recommending that shareholders vote against the bid, or searching for a white knight. While most bids do eventually result in a friendly, negotiated deal, the bid is considered hostile if the target, at any time, takes a defensive stance.

IV. Evidence On Runup in Stock Prices of Takeover Targets

A. Improvement To Measuring Runup Using News-Adjusted Date

In 70 of the 172 takeovers in our sample, our NA dates are earlier than the formal WSJ announcement dates (the event dates generally used in the finance literature -- what we've call "finance" dates). Tables 1 and 2 compare our runup results based on this alternative date specification. The first column in each table indicates the trading day in relation to the event date, where -20 indicates twenty trading days before the event date, +1 is one trading day after the event date, and so on. Columns 2 and 3 indicate the mean cumulative abnormal return (CAR) and the t-statistic of that CAR for the sample using the NA date as the event date. Columns 4 and 5 provide similar information for the sample using the finance date as the event date.

The runup index in columns 6 and 7 provides a method through which to compare runup. This index indicates the ratio of the mean CAR on each trading day to the mean CAR on the day following

the event day. Day +1 is used as the standard for measuring runup because by the close of the day after the announcement all investors will have had the opportunity to react to and trade on the information from the announcement.

Our results indicate that there is a substantial amount of runup in stock prices before the announcement of a tender offer. When using the NA date as the event date, a steady increase in the runup index can be observed beginning as far back as 15 days before the announcement. By one day prior to the announcement, the average stock price had appreciated to almost 39 percent of the price one day after the announcement. Note that the smooth increase in the runup index does not necessarily imply that the stock price of each firm gradually appreciated, rather that the average over all firms did so. If stock price reaction to takeover rumors for each firm occurred in one-time adjustments and were distributed over the 20 days before the NA date, with more rumors closer to the NA date, we would see the exact same pattern of average runup.

Comparing our results from the NA date to our results from using the finance date, we see a difference in the runup. Starting from about 10 trading days before the formal announcement, the runup index using the finance date is greater than the runup index using the NA date, as illustrated in the last column. By one day prior to the finance date, share prices have appreciated over 46 percent compared to the 39 percent using the NA date. This seven percent differential in runup represents

about 19 percent of the total runup reported using the NA date. Our evidence show that, for validity, any statements about runup using general studies of tender offers and the effect of formal announcements must be carefully couched to recognize that the market has already reacted to "in play" rumors.

The need for caution is clearly demonstrated when we compare runup from the subsample of 70 firms in which the NA date differs from the finance date. These are the firms for which we were able to identify "in play" dates that preceded the formal announcement of a tender offer. Table 2 presents the CARs and runup index for this subsample. For the 70 firms that were "in play" according to the Dow Jones Ticker or the WSJ, the runup index one day before the formal announcement as indicated by the finance date is a remarkably high 70 percent. Clearly, investors had reacted to the increased probability that the firm would be the target of a tender offer. The runup index 16 trading days before the formal announcement is already up to 10 percent of the total appreciation one day after the formal announcement.

The adjusted runup for the subsample with an "in-play" date earlier than the finance date is substantially less than that using the finance date. On the day before the announcement, stock prices had appreciated to 46 percent of what they would be by the day after the NA date as compared to the 70 percent from using the finance date. This differential of 24 percentage points reflects an overestimation of runup of more than 50 percent when using the finance date.

Earlier studies by Bradley and by Keown and Pinkerton report almost 50 percent runup in stock prices if measured in a manner similar to our runup index. This runup is roughly analogous to the 46.1 percent runup we find over our sample of 172 offers in the 1980s, using formal announcement dates. If we could find similar MA dates for their samples, we would probably find that their results overestimate runup by about the 20 percent we report over our sample of 172 offers.

These results emphasize the importance of using the MA date in determining runup. The formal announcement date is certainly the appropriate date to be used if one is interested in finding premiums paid to shareholders once the offer is certain. However, public speculation about an impending bid may begin well before that formal announcement.

B. Runup in Secret versus Rumored Tender Offers

It is inappropriate to talk about all runup as evidence of insider trading if there has been speculation (not definite enough to be used as the MA date) in publicly available news sources that the firm may be the target of a tender offer. The substantial premiums paid to shareholders in the event of a tender offer encourages investment in these firms -- there are money management funds which concentrate investments in potential targets, arbitragers for whom a takeover rumor causes an immediate "buy" order. Anything that increases the probability that the firm will be a target results in increased trading in that firm -- as shown by our MA versus finance date. In the 70

cases where the MA date precedes the formal announcement, it is still clearly evaluated as an increase in the probability of an offer. Table 2 reports an average CAR of 20 percent from 20 trading days before to one trading day after the MA date.

In an attempt to eliminate the influence of public rumors from being included in our runup index, we have split the sample into "secret" and "rumored" categories. Those tender offers denoted as rumored are those where either the Dow Jones News Service or the WSJ reported speculation that the firm might be the target of a takeover bid, but the information was not significant enough to classify as the MA date. Out of the 172 targets, 103 are denoted as secret and 69 are denoted as rumored.

Table 3 reports the CARs and the runup index for the secret and rumored subsamples, using the MA date as the event date. The runup index for the rumored offers is substantially higher than the runup index for the secret offers, as shown in the last three columns. Fifteen days before the MA date, the rumored offers have already appreciated 10 percent of their eventual appreciation one day after the MA date, while the secret offers show only a 2.6 percent runup. Ten days before, the rumored offers have appreciated 17.6 percent while the secret offers show only a 5 percent runup. Two days before the MA date, there is still a remarkable difference -- rumored offers have experienced 43.5 percent of their eventual runup while secret offers show only a 19 percent runup. On the day before the MA date, the 50.3

percent runup for rumored offers outpaces the runup of 32.7 percent for secret offers by almost 18 percent.

We define "rumored" very simply -- the presence of published news stories in the WSJ, or on the Dow Jones Ticker, reporting takeover-related rumors. The multitude of possible other sources of takeover rumors emphasizes the caution which must be taken when one suggests that runup before takeover announcements is due primarily to illegal insider trading. We find that runup is overestimated by more than 50 percent in our very simple test; if we could include all rumors, trends and gossip found on Wall Street, we could probably further explain much of the pre-bid trading activity. It is difficult to make any assertions about illegal insider trading when we cannot completely account for the effects all rumors.

C. Runup as Related to Foothold of the Bidder

One of the characteristics of the pre-bid period of a tender offer that arbitragers suggest enables them to predict tender offer targets is large purchases of the target stock by the bidder. Unusual trading volume and an increased number of block trades are directly observable by those whose profession is based on accurately predicting takeover targets. Runup in stock prices that is based on these observations would be the result of a perfectly legitimate source of information.

Overall, our inability to determine when the footholds were acquired weakens the test of the relation between foothold and runup. The level of the foothold at the time of the bid serves

as the proxy for recent observable acquisitions. However, large footholds held for long periods of time will distort the expected positive relation between foothold and runup. Thus, we eliminate five tender offers from our sample in the following discussion. These targets are excluded because the ownership position of the bidder was long term (held at least six months) and very high. In each case, the bidder held over 40 percent of the firm and there was no evidence of any recent acquisitions by the bidder. These characteristics do not fit the pattern we expect to observe between a large foothold and runup.[12]

Table 4 presents the runup index for our tender offer sample divided into several categories reflecting the size of the initial bidder's foothold. The first three columns divide the offers with non-zero footholds into three approximately equal-sized groups, ranked according to the size of the bidder's foothold. The average foothold is 2.56 percent for the first group, 8.06 percent for the second group and 21.74 percent for the third group. The last column reports runup for those 72 targets in which the bidder had no holdings.

Comparing the runup for the non-zero foothold groups, the runup index increases as the foothold increases. For the lowest ranked group, the index is at 1.3 percent ten trading days before the offer, 6.2 percent five trading days before the offer and 26.5 percent one trading day before the offer. For the middle group, the index is already at 14 percent ten trading days before the offer, 20 percent five days before the offer and almost 43

percent the day before the offer. For the group with mean footholds of 21.7 percent, the runup index is 8.7 percent ten days before the offer, 30 percent five days before the offer and almost 48 percent one day before the offer. Overall, these numbers support the hypothesis that the larger the foothold of the bidder, the greater will be the runup in stock price.

As shown above, if the possibility of an offer has been discussed in the media before the NA date, there is substantially more runup than if the offer can be classified as secret. In Table 5, we have classified the positive foothold firms into secret and rumored categories and then divided those categories into three groups based on foothold size. This allows us to consider whether press speculation has an independent effect on runup in addition to the foothold of the bidder. Overall, average foothold in the 61 secret offers is 9.19 percent and average foothold in the 34 rumored offers is 13.85 percent.

The first column of Table 5 reports the runup index for the smallest foothold group of secret offers (average foothold is 2.1 percent) and the second column reports the runup index for the smallest foothold group of rumored offers (average foothold is 4.0 percent). Columns 3 and 4 report similar evidence for the middle foothold group (6.4 percent for secret offers and 12.2 percent for rumored offers) and columns 5 and 6 report for the largest foothold group (19.2 percent and 25.5 percent).

The difference between secret and rumored offers is striking. For the smallest foothold group, there is essentially

no runup in the secret category. Two days before the bid, runup is still only 1.8 percent of the eventual premium over 20 cases. For the 11 rumored bids with the smallest foothold, the runup index is over 50 percent by two days before the bid, and had reached almost 14 percent ten days before the bid.

This pattern is observed in the two larger foothold categories also. For the middle foothold groups, ten days before the NA date the runup index is about 10 percent in the secret category and 17 percent in the rumored category. Two days before the bid, runup in the secret category is 20 percent as opposed to almost 47 percent in the rumored category. For the largest foothold groups, the runup index increases even more slowly in the secret category as opposed to the rumored category. Ten days before the offer, the index is negative for the secret group and already 15 percent in the rumored group. Five days before, the secret index is 9.5 percent versus 46 percent in the rumored category. Two days before the offer, the secret index is 24 percent and the rumored index is 66 percent.

Even though it is probable that some rumors and news stories concerning tender offers are directly attributable to foothold acquisitions of the bidder, the evidence shows that whether the offer is secret or rumored has an independent effect on runup apart from share purchases. When foothold blocks are held constant, we still find substantial differences between runup in secret versus rumored offers.

The last column of Table 4 reports the runup index for offers in which the bidder held no shares of the target. Paradoxical evidence is found in these 72 offers. In these cases, the runup index increases almost as rapidly as in the two groups with the largest footholds. This exception from the expected pattern leads us to consider how the zero footholds differ from those with positive footholds. Table 6 provides some evidence on the characteristics of each foothold category.

The first row of Table 6 reports the percent hostile and the percent secret offers for the 72 offers in which the bidder has no foothold. The second row presents the same information for the 95 offers we consider with positive footholds. (These same figures are reported for the positive footholds by size category below the dotted line.) Two factors stand out from this table. First, the zero foothold group is characterized by a relatively few number of contested bids, with only 35 percent of the bids being hostile as opposed to 66 percent for the non-zero footholds. Second, 56 percent of the offers in the zero foothold group are classified as secret. This is similar to the 65 percent for all non-zero footholds and the 66 percent and 47 percent secret in the two largest foothold categories, respectively. However, 81 percent of the offers in the smallest foothold category are secret. These two attributes suggest considering the zero foothold group independently, thus holding the effect of foothold constant, to determine if friendly versus hostile bids affect runup.

D. Friendly versus Hostile Offers

The differential effects of friendly versus hostile offers are difficult to predict. In a hostile bid, the bidder may hope to surprise the target so that it does not have the opportunity to make defensive moves such as the adoption of a poison pill, selling significant assets or restructuring its capital base to make the firm less attractive to the bidder.[13] Thus, the hostile bidder may have more incentives to keep the bid secret. However, the hostile bidder may prefer to have the stock of the target firm in the hands of arbitragers when he announces the bid. If the bidder anticipates that arbitragers would be more willing than other shareholders to tender into the offer, the bidder's incentives may result in him being less careful in keeping the bid secret.

If the bid is friendly, it is likely that there are more negotiations between the two firms with twice as many people having knowledge of the impending bid. This increases the probability of intentional or unintentional leakage of information concerning the impending bid and of observing runup before the bid. In general, negotiated merger announcements are accompanied by more runup than tender offer announcements. If friendly offers are similar to negotiated mergers, more runup in friendly offers would be consistent with this pattern of stock price changes.

Overall, we find very little difference between runup in friendly versus hostile bids when considering all 172 cases.

Over the period ten trading days to five trading days before the NA date, there is slightly more runup in the friendly category, as reported in Table 7. However, in both friendly and hostile cases, the runup one day before the offer is at 38.8 percent of the share price increase one day after the offer.

The last two columns of Table 7 report runup for friendly and hostile offers in which the bidder holds no shares at the time of the bid. This allows us to hold constant the effect of any open market acquisitions that might be observed by information specialists. In friendly offers, there is substantially more runup. Fifteen trading days before the NA date, share prices have already appreciated by 12 percent of the eventual control premium for friendly offers. For hostile offers, there is only a two percent appreciation. At five trading days before the NA date, the runup index for friendly offers is at 21.3 percent and only 17.2 percent for hostile offers. On the day before the bid, friendly offers with no footholds have a runup index of 47.1 percent while hostile offers have only a 35.3 percent runup index.

Our empirical evidence cannot determine why there is more runup in friendly offers than hostile ones. It may true that hostile bidders have more incentives to keep the bid secret. Defensive maneuverings by the target can significantly increase the cost of the takeover; the less time the target has to take action, the better off the hostile bidder. There may also be more runup in friendly bids because twice as many lawyers,

investment bankers, and officers and directors have the opportunity to leak the information, whether inadvertently or illegally. Further analysis of the differences between hostile and friendly offers is required before we can adequately explain the differential runup.

V. Evidence On Trading Volume Changes for Takeover Targets

A. Volume Changes in Secret versus Rumored Tender Offers

Table 8 reports the daily standardized volume figures for all tender offers in our sample and for the secret and rumored categories, using the NA date as the announcement date. For all bids, the average standardized volume is double what it was over the control period as early as 10 days prior to the NA date. By two days before, it's three times normal and five times normal on the day before the announcement. Once the news is public, volume jumps to 20 times normal. It seems clear that there is trading related to the announcement at least ten days before the offer is made. Volume remains over five times normal until at least ten days after public announcement.

In comparing the secret bids to the rumored ones, we find substantial differences in trading volume. In the secret cases, double normal volume is not observed until five days before the NA date. On day 0, volume jumps to 25 times normal as investors react to the surprise news. However, in rumored transactions, volume is close to or more than double from 20 days before the offer. As the NA date approaches, daily standardized volume for the rumored offers is less than that of the secret offers and on

the NA date, volume is only 12 times normal. This suggests that with respect to rumored offers more investors have already adjusted their portfolios by the NA date.

Looking across the table to friendly and hostile offers, there do not seem to be significant differences between the trading volume of these categories. This corroborates the evidence of only small differences between these groups in the runup of stock prices. The effects of media speculation and foothold acquisitions seem to dominate the effects of friendly versus hostile bids in our data.

The continual high trading volume for all types of offers after the NA date reflects the importance of risk arbitrage activity in the takeover process. Most of those selling in the market immediately following the bid are probably small investors selling to risk arbitragers. These sellers prefer to sell their shares at a certain price slightly below the offered premium, rather than bear the risk that the bid may not be successful and their shares will return to the pre-bid price. Risk arbitragers are willing to buy those shares and hold them until the realization of the offer. Despite the failure of some offers, arbitragers, on average, earn profits because their holdings are diversified over many offers.

B. Volume Changes as Related to Foothold

Table 9 reports volume activity for the tender offer targets broken into groups based on the size of the foothold acquisition of the bidder. The first three columns present standardized

trading volumes for the smallest, middle and largest foothold groups, respectively. The fourth column reports standardized trading volumes for offers in which the bidder has no foothold.

For those offers in which the bidder has the smallest, positive foothold, there is the largest reaction in trading volume on the NA date. This supports the evidence reported for the secret versus rumored categories that the offers which are the greatest surprise to the market have the largest volume on the NA date and the few days following the announcement. For this group, volume on the day of the offer is more than 25 times normal.

For the offers with the middle- and largest-sized footholds, the trading volume activity on the NA date declines as the size of the foothold increases. For the middle foothold group, volume is not quite 25 times normal on the NA date and for the largest foothold group, volume is only 11 times normal. This suggests once again that by the time the bidder has acquired (on average) 20 percent of the target stock, other traders have recognized the unusual buying activity and have adjusted their portfolios in reaction to that acquisition well before the official announcement.

As noted above, the zero foothold group is dominated by friendly offers (65 percent of the offers). The standardized volume figures reported for the zero foothold group are very similar to those reported in Table 8 for all friendly offers. On the NA date, volume is about 19 times normal and on the day after

the offer, volume is about 22 times normal in zero foothold offers and in all friendly offers.

VI. Conclusion

This study presents data on pre-bid stock trading for 172 NYSE and AMEX takeover targets between 1981 and 1985. Besides showing improved measures of net-of-market runup in stock prices during the twenty days before public announcement, we examine how other factors affect pre-bid market activity. These include the presence of media speculation, the size of any foothold acquisitions by the (usually hostile) bidder, and whether the initial bid is friendly or contested.

In sum, runup is 38.8 percent of the total eventual control premium as of the close of trading the day before the public announcement, averaged over all 172 cases. As of the close of the second day before announcement, runup is 27.6 percent, and it is 22.7 percent three days before. Across all 172 cases, runup becomes statistically significant about 17 trading days before public announcement. Roughly one-third of pre-bid runup can be attributed to takeover speculation in the media. In bids with no rumors reported in the press, the runup index is only 32.7 percent one day before announcement, compared with a 50.3 percent average for bids with rumors.

Larger foothold acquisitions by the bidder also coincide with more pre-bid market activity. Also, there is some evidence from the 72 cases having zero footholds that friendly, negotiated bids have more runup in stock prices than do hostile bids. This

result has some intuitive appeal in view of the strong motives for secrecy during the immediate time preceding a hostile bid.

Trading volume on the day of public announcement surges to 20 times its historical daily average. It is five times normal the day before the announcement and triple two days before the announcement. Bids preceded by media speculation have lower volume surges on announcement day, and higher levels in the period leading up to announcement. Averaged over all cases, volume reaches double its historical norm ten trading days before public announcement, and increases steadily until the bid. It remains at nearly five times normal as late as ten trading days after public announcement.

These statistics tell a story of an active market for information about impending takeover bids. Although we do not observe or report here runup occuring in the absence of an eventual takeover bid, these 172 takeover cases show that trading on information about impending bids is significant. The pattern is also consistent across time; the runup measures shown here are very similar to estimates based on samples covering 1962-1980.

The statistical relations we measure between pre-bid activity and media speculation, footholds and friendly/hostile variables do not provide a complete response to contentions that insider trading is the dominant source of the information that spurs runup. We are unable to explain a great deal of the pre-bid trading. Also, it is possible, and logical to many, that illegal insider behavior could affect simultaneously runup and

these other factors. Media speculation, for example, may usually emanate from "street talk," which could be ultimately fed by illegal disclosures.

On the other hand, a case can be made that the strong effects of foothold buying and media speculation on pre-bid market activity reflects a legitimate market for information. Systematic relationships between footholds or news stories and pre-bid market activity supports the existence of this market and suggests that significant pre-bid market activity is consistent with having little illegal insider trading. This conclusion implies that aggregate runup statistics are of little value as measures of illegal insider activity, although measures for individual stocks can still serve as very useful enforcement tools. Further research on the sources of information about impending takeovers is required to determine the ultimate source of pre-takeover bid trading in target stocks.

NOTES

1. In May 1986, the SEC charged Dennis Levine, an investment dealer at Drexel Burnham Lambert, with illegally trading in stocks and options of 54 companies. It alleged that Levine had made a profit of $12.6 million by trading on inside information related to actual or proposed tender offers, mergers and other business combinations.
Ivan Boesky agreed to pay $100 million and to plead guilty to one felony count to settle charges of insider trading. The settlement was announced by the SEC in November 1986. According to the SEC complaint, Levine passed on inside information to Boesky, resulting in at least $50 million profits to Boesky.

2. See for example, "My Cousin Works for This Guy Who...," Forbes Magazine, February 10, 1986, "Spotlight on the Insiders," The Washington Post, September 21, 1986, and "Post-Levine Trauma Ends, but Arbitragers Are Hurt by Fallout," The Washington Post, October 28, 1986. All of these articles include comparisons of stock prices and volumes of major takeover targets before and after the announcement of the offer and relate these figures to insider trading. Some academic researchers take this position also. Keown and Pinkerton (1981) state that most of the runup in their sample of mergers can be directly ascribed to insider trading, though they offer no evidence for this conclusion.

3. See, for example, Bradley (1980), Keown and Pinkerton (1981), and Jensen and Ruback (1983).

4. When traders with better information (whether gained legally or not) profit from their investment positions, they presumably do so at the expense of less informed investors. The anonymous nature of most stock trading makes it difficult to determine who loses what the information specialist gains. Those selling into the market when the better-informed are buying probably would not have sold had they possessed the same valuable information. However, they still would have sold if the information specialist had refrained from buying, especially if the trading of the specialist did not affect significantly the stock price. This holds true whether the trading is based on insider information or on careful analysis and successful anticipation of the event.

5. Many studies have documented the large premiums paid to shareholders of takeover targets. The Office of the Chief Economist (OCE, 1985) reports that on average from 1981 through 1984, shareholders received a price 50 percent greater than the price at which the shares were trading prior to the offer.

6. Well-informed traders have strong incentives to minimize "leakage" of information that allows other traders to free-ride on their knowledge. Information specialists know that leakage is greater the larger the investment position and the more quickly

it is assembled. Also differences in market conditions affect their ability to trade without information leakage. High variance in daily volume, perhaps caused by sporadic trading by institutional traders, and sophisticated techniques for masking the trader's identity can allow larger investment positions to be assembled with less leakage of information.

7. The SEC recently recommended to Congress that they adopt legislation to close the gap for filing the Schedule 13D from ten days to two days after crossing the five percent ownership threshold.

8. For example, see Poulsen (1984), Mikkelson and Ruback (1985) and Holderness and Sheehan (1985). These studies report an average three to seven percent appreciation in share price (net of market) at the 13D Schedule filing date.

9. We take this opportunity to thank Professor Robert Comment of New York University for providing us with a great deal of assistance in the use of this data source.

10. Levine was charged with illegal trading in twelve of the tender offers included our sample. Of those twelve, six were discussed in the media as probable takeover targets before our NA date. For our entire sample, 40 percent were discussed in the media prior to the bid.

11. As noted above, most authors recognize that the information in the WSJ is generally available to investors the day before it appears in the paper.

12. The five excluded firms and the ownership positions of the bidder are reported below:

Target	Holdings of Bidder
Guardian Industries	43 Percent
Braun Engineering	43 Percent
Juniper	49 Percent
Gaylords	49 Percent
MGM	50 Percent.

13. Jarrell (1985) reports that for 75 percent of 100 targets that litigated in opposition to a bid, the eventual takeover premium is significantly higher. If the litigation occurred at the same time as an auction for the firm, the takeover premium was increased an average of 17 percent.

TABLE 1

Cumulative Abnormal Returns (CARs) and Runup Index (in Percent) for 172 Exchange-Listed Tender Offers From 1981 Through 1985, Using News-Adjusted and Finance Dates As Announcement Date

Trade Day	News-Adjusted Date* CAR	News-Adjusted Date* t-Statistic	Finance Date** CAR	Finance Date** t-Statistic	News-Adjusted Runup	Finance Runup
-20	-0.001	-0.513	0.001	0.332	-0.3	0.2
-19	0.003	1.081	0.006	2.228	0.9	2.1
-18	0.004	1.258	0.006	1.994	1.3	2.3
-17	0.007	1.935	0.005	1.322	2.4	1.8
-16	0.010	2.704	0.012	2.995	3.7	4.5
-15	0.014	3.422	0.014	3.084	5.1	5.1
-14	0.016	3.402	0.014	2.993	5.5	5.3
-13	0.018	3.752	0.016	3.181	6.5	6.0
-12	0.024	4.671	0.018	3.388	8.6	6.8
-11	0.024	4.416	0.021	3.717	8.5	7.9
-10	0.027	4.652	0.028	4.711	9.4	10.5
-9	0.031	5.163	0.033	5.205	10.9	12.1
-8	0.034	5.454	0.034	5.115	12.0	12.4
-7	0.038	5.898	0.038	5.629	13.5	14.2
-6	0.041	6.197	0.042	5.963	14.7	15.5
-5	0.049	7.144	0.049	6.724	17.5	18.1
-4	0.055	7.702	0.054	7.150	19.4	19.8
-3	0.064	8.750	0.065	8.471	22.7	24.2
-2	0.078	10.350	0.089	11.277	27.6	33.0
-1	0.110	14.187	0.125	15.327	38.8	46.1
0	0.249	31.429	0.248	29.737	88.1	91.6
1	0.283	34.863	0.271	31.728	100.0	100.0
2	0.283	34.160	0.274	31.341	100.2	101.0
3	0.286	33.760	0.274	30.768	101.1	101.3
4	0.289	33.458	0.278	30.535	102.3	102.6
5	0.291	32.992	0.279	30.072	102.9	103.0

* Standard deviation of mean residual from days (-170) to (-21) = .001727

**Standard deviation of mean residual from days (-170) to (-21) = .001820

TABLE 2

Cumulative Abnormal Returns (CARs) and Runup Index (in Percent) for 70 Exchange-Listed Tender Offers From 1981 Through 1985, Using News-Adjusted and Finance Dates As Announcement Date, For Offers with News-Adjusted Dates Not Equal to Finance Dates

Trade Day	News-Adjusted Date* CAR	News-Adjusted Date* t-Statistic	Finance Date** CAR	Finance Date** t-Statistic	News-Adjusted Runup	Finance Runup
-20	-0.001	-0.315	0.003	0.922	0.3	[illegible]
-19	0.004	1.217	0.012	2.716	1.8	[illegible]
-18	0.009	2.070	0.015	2.831	3.7	7.2
-17	0.018	3.657	0.014	2.228	7.6	6.5
-16	0.017	3.055	0.022	3.094	7.1	10.1
-15	0.019	3.141	0.018	2.314	8.0	8.3
-14	0.025	3.750	0.022	2.704	10.4	10.4
-13	0.030	4.266	0.026	2.914	12.6	12.0
-12	0.033	4.313	0.019	1.997	13.5	8.7
-11	0.030	3.735	0.023	2.349	12.3	10.8
-10	0.027	3.283	0.032	3.088	11.4	15.0
-9	0.033	3.787	0.038	3.510	13.7	17.8
-8	0.034	3.708	0.033	2.919	14.0	15.4
-7	0.041	4.366	0.042	3.586	17.1	19.6
-6	0.046	4.659	0.047	3.898	18.8	22.0
-5	0.056	5.594	0.055	4.457	23.4	26.0
-4	0.064	6.148	0.061	4.757	26.5	28.6
-3	0.074	6.947	0.078	5.877	30.8	36.4
-2	0.083	7.586	0.112	8.247	34.5	52.5
-1	0.112	9.922	0.149	10.727	46.3	70.0
0	0.202	17.466	0.200	14.036	83.6	93.9
1	0.242	20.411	0.213	14.601	100.0	100.0
2	0.239	19.757	0.216	14.473	99.0	101.4
3	0.246	19.878	0.218	14.294	101.7	102.3
4	0.246	19.481	0.218	14.049	101.7	102.6
5	0.248	19.299	0.220	13.872	102.8	103.3

* Standard deviation of mean residual from days (-170) to (-21) = .002523.

**Standard deviation of mean residual from days (-170) to (-21) = .003109.

TABLE 3

Cumulative Abnormal Returns (CARs) and Runup Index (in Percent) for 172 Exchange-Listed Tender Offers From 1981 Through 1985, Using News-Adjusted Announcement Date, Classified as "Secret" (n=103) or "Rumored" (n=69)

Trade Day	Secret Offers* CAR	Secret Offers* t-Statistic	Rumored Offers** CAR	Rumored Offers** t-Statistic	Secret Runup	Rumored Runup
-20	-0.003	-1.155	0.002	0.633	0.8	0.7
-19	0.001	0.244	0.005	1.511	0.2	2.2
-18	0.002	0.530	0.006	1.438	0.7	2.6
-17	0.003	0.617	0.013	2.468	0.9	5.1
-16	0.006	1.153	0.018	3.072	1.9	7.1
-15	0.008	1.448	0.024	3.900	2.6	9.9
-14	0.007	1.134	0.029	4.275	2.2	11.8
-13	0.011	1.765	0.029	4.048	3.6	11.9
-12	0.016	2.394	0.037	4.782	5.2	14.9
-11	0.015	2.127	0.038	4.698	4.8	15.5
-10	0.016	2.136	0.043	5.086	5.1	17.6
-9	0.019	2.428	0.049	5.571	6.1	20.1
-8	0.021	2.572	0.054	5.875	6.7	22.0
-7	0.025	2.962	0.058	6.118	8.0	23.8
-6	0.025	2.916	0.066	6.682	8.1	26.9
-5	0.029	3.303	0.079	7.780	9.5	32.4
-4	0.034	3.685	0.086	8.227	11.0	35.3
-3	0.047	5.005	0.090	8.282	15.3	36.6
-2	0.059	6.086	0.106	9.581	19.1	43.5
-1	0.101	10.142	0.123	10.797	32.7	50.3
0	0.268	26.398	0.220	18.814	87.2	89.7
1	0.308	29.581	0.245	20.482	100.0	100.0
2	0.311	29.269	0.241	19.699	101.2	98.3
3	0.314	28.872	0.244	19.539	101.9	99.6
4	0.319	28.739	0.245	19.201	103.6	99.9
5	0.320	28.333	0.246	18.942	104.1	100.5

* Standard deviation of mean residual from days (-170) to (-21) = .002217.

**Standard deviation of mean residual from days (-170) to (-21) = .002548.

TABLE 4

Runup Index (in Percent) for 167 Exchange-Listed Tender Offers, From 1981 Through 1985, Classified by Foothold Acquistion of Bidder (Average Foothold in Percent in Parentheses)

Trade Day	31 Offers Smallest Foothold ($\bar{x}$=2.56)	32 Offers Middle Foothold ($\bar{x}$=8.06)	32 Offers Largest Foothold ($\bar{x}$=21.74)	Zero Foothold
-20	0.4	1.0	0.8	-0.5
-19	-0.7	0.9	0.0	1.5
-18	0.0	0.9	0.0	1.9
-17	-0.3	4.1	1.7	2.9
-16	0.0	6.6	3.7	4.3
-15	0.7	6.3	3.0	8.6
-14	-2.1	7.0	3.8	10.5
-13	-2.4	11.1	5.9	9.8
-12	0.4	14.9	6.5	11.1
-11	0.8	14.4	6.4	11.7
-10	1.3	12.7	8.7	14.0
-9	1.3	12.6	12.1	16.9
-8	1.5	15.2	15.5	16.6
-7	2.6	18.0	22.0	16.3
-6	4.1	18.9	26.3	16.4
-5	6.3	20.2	30.8	19.8
-4	7.7	22.4	32.5	21.6
-3	6.7	30.6	34.3	25.6
-2	10.2	36.4	40.2	30.6
-1	26.5	42.9	47.7	42.6
0	84.8	86.9	89.9	88.6
1	100.0	100.0	100.0	100.0
2	100.1	100.0	99.1	100.8
3	101.6	99.9	101.3	101.7
4	102.5	101.7	104.2	101.9
5	102.9	101.9	102.4	103.3

TABLE 5

Runup Index (in Percent) for 167 Exchange-Listed Tender Offers, From 1981 Through 1985, Classified by Foothold Acquistion of Bidder and "Secret" or "Rumored" (Average Foothold in Percent in Parentheses)

	Smallest Foothold		Middle Foothold		Largest Foothold	
Trade Day	n=20 Secret ($\bar{x}$=2.1)	n=11 Rumored ($\bar{x}$=4.0)	n=21 Secret ($\bar{x}$=6.4)	n=12 Rumored ($\bar{x}$=12.2)	n=20 Secret ($\bar{x}$=19.2)	n=11 Rumored ($\bar{x}$=25.5)
-20	0.3	-1.5	-0.6	3.1	1.7	-1.8
-19	0.2	-2.6	-0.8	5.0	-0.3	1.4
-18	2.6	-4.6	-1.6	6.6	1.1	-1.3
-17	2.1	-1.1	-1.1	13.0	1.9	0.2
-16	2.8	4.1	-0.7	12.9	6.1	-1.1
-15	3.2	5.2	0.4	12.2	5.5	-3.0
-14	1.1	4.0	-1.0	17.4	4.2	-2.5
-13	0.3	4.0	2.2	23.2	5.4	1.3
-12	-1.7	13.4	9.4	22.3	0.2	10.2
-11	0.5	11.0	9.9	20.2	-1.9	13.2
-10	-0.6	13.9	9.6	17.1	-0.3	15.2
-9	-1.6	18.0	6.9	18.0	4.0	20.5
-8	-1.6	18.3	8.7	23.6	5.0	27.5
-7	-2.4	24.5	11.1	27.6	8.9	36.3
-6	-2.0	33.1	9.9	30.0	9.5	46.0
-5	-0.5	39.2	10.8	30.0	13.2	51.8
-4	0.4	46.2	10.4	32.7	14.1	56.7
-3	-1.6	45.4	14.6	43.0	22.6	52.0
-2	1.8	51.8	20.4	46.6	24.0	66.1
-1	25.4	56.4	27.8	47.9	35.3	71.6
0	82.9	92.3	82.5	90.0	90.8	91.6
1	100.0	100.0	100.0	100.0	100.0	100.0
2	99.4	98.8	102.1	95.4	99.4	101.4
3	102.0	98.6	102.4	99.1	101.8	96.5
4	104.6	98.3	104.1	90.4	103.3	94.2
5	105.3	100.6	104.5	99.9	99.8	99.8

TABLE 6

Characteristcs of 167 Exchange-Listed
Tender Offers From 1981 to 1985, Categorized
By Foothold, Average Foothold in Parentheses

Foothold	Percent Hostile	Percent Secret
72 Offers Zero Foothold	35	56
95 Offers Positive Foothold ($\bar{x}$=10.9%)	66	65
Smallest Foothold ($\bar{x}$=2.56%)	55	81
Middle Foothold ($\bar{x}$=8.06%)	78	66
Largest Foothold ($\bar{x}$=21.74%)	66	47

TABLE 7

Runup Index (in Percent) for 172 Exchange-Listed Tender Offers,
From 1981 Through 1985, and For 72 Offers
With Zero Footholds, Classified as
Hostile or Friendly

	All Offers		Zero Foothold Offers	
Day	Friendly (n=89)	Hostile (n=83)	Friendly (n=47)	Hostile (n=25)
-20	-0.3	-0.3	0.2	-1.5
-19	1.8	0.2	2.8	-0.8
-18	2.7	0.1	3.0	-0.1
-17	3.6	1.3	4.9	-0.5
-16	3.8	3.6	5.9	1.6
-15	7.3	3.2	12.4	2.4
-14	7.1	4.1	13.6	5.6
-13	7.2	5.8	12.7	5.1
-12	9.3	7.9	14.0	6.4
-11	10.3	7.0	15.2	5.8
-10	11.7	7.5	17.0	9.2
-9	12.9	9.2	18.6	14.1
-8	13.8	10.5	18.0	14.3
-7	15.9	11.4	17.6	14.1
-6	15.9	13.6	18.3	13.4
-5	18.6	16.5	21.3	17.2
-4	19.3	19.5	23.0	19.4
-3	22.7	22.7	28.2	21.3
-2	26.5	28.5	34.1	24.9
-1	38.8	38.8	47.1	35.3
0	90.5	86.0	91.2	84.4
1	100.0	100.0	100.0	100.0
2	101.5	99.1	103.2	96.7
3	103.2	99.3	105.6	95.3
4	104.6	100.3	105.4	96.1
5	106.1	100.0	107.2	96.9

TABLE 8

Standardized Volume for 172 Exchange-Listed Tender Offers From 1981 Through 1985, Each Offer Classified as Secret or Rumored and Friendly or Hostile

Day	All Offers (n=172)	Secret Offers (n=103)	Rumored Offers (n=69)	Hostile Offers (n=83)	Friendly Offers (n=89)
-20	1.417	1.206	1.721	1.318	1.511
-19	1.505	1.134	2.064	1.518	1.492
-18	1.386	1.094	1.822	1.324	1.446
-17	1.700	1.412	2.128	1.756	1.649
-16	1.950	1.497	2.624	2.267	1.642
-15	1.814	1.706	1.973	1.965	1.669
-14	1.729	1.553	1.983	2.232	1.249
-13	1.826	1.375	2.487	1.859	1.794
-12	1.775	1.467	2.235	1.848	1.705
-11	1.698	1.468	2.038	2.214	1.206
-10	2.156	2.160	2.150	2.497	1.835
-9	2.128	1.827	2.571	2.329	1.940
-8	2.127	1.849	2.529	2.218	2.040
-7	2.014	1.506	2.800	1.937	2.086
-6	2.205	1.779	2.821	2.062	2.337
-5	2.379	2.148	2.713	1.972	2.757
-4	2.336	1.925	2.931	2.176	2.489
-3	3.037	2.679	3.565	2.957	3.113
-2	3.237	2.857	3.631	3.136	3.330
-1	5.165	5.192	4.842	4.871	5.451
0	19.963	22.578	14.710	21.170	18.887
1	20.776	23.233	17.127	19.432	22.025
2	13.693	16.286	9.803	11.585	15.677
3	10.292	10.705	9.673	9.797	10.758
4	9.166	9.985	7.918	8.705	9.594
5	7.936	8.729	6.728	7.167	8.669
6	8.296	8.972	7.267	8.197	8.389
7	7.482	7.792	7.018	5.851	9.034
8	7.288	7.622	6.788	4.345	10.059
9	5.561	6.128	4.710	3.677	7.334
10	4.671	5.114	4.006	3.635	5.646

TABLE 9

Standardized Volume for 167 Exchange-Listed Tender Offers From 1981 Through 1985, Each Offer Classified by Foothold Acquistion of Bidder

Trading Day	Smallest Foothold (n=31)	Middle Foothold (n=32)	Largest Foothold (n=32)	Zero Foothold (n=72)
-20	1.279	1.587	1.177	1.518
-19	1.097	1.690	1.030	1.859
-18	0.944	1.813	0.758	1.702
-17	1.116	1.827	0.852	1.830
-16	1.850	2.448	1.501	2.022
-15	1.449	1.677	1.827	1.996
-14	1.097	2.154	1.056	2.012
-13	1.379	1.802	2.537	1.787
-12	1.560	2.176	1.271	1.966
-11	1.352	1.357	1.107	1.970
-10	1.574	2.918	1.149	2.158
-9	1.578	2.450	1.536	2.507
-8	1.425	3.114	1.594	2.169
-7	1.688	2.156	2.057	2.179
-6	1.669	3.257	2.677	1.780
-5	1.705	3.377	3.032	1.961
-4	2.237	2.316	2.294	2.457
-3	3.141	3.000	2.128	3.465
-2	2.582	3.677	3.397	3.286
-1	5.098	5.446	3.142	6.219
0	25.969	24.489	11.440	19.255
1	22.967	24.710	12.425	22.020
2	15.439	18.019	8.367	12.547
3	10.753	12.534	7.982	10.234
4	10.686	10.498	8.384	8.453
5	8.643	8.005	5.798	8.844
6	7.782	8.968	8.001	8.368
7	8.684	9.190	7.492	6.493
8	9.623	10.020	4.332	6.710
9	5.805	6.020	5.175	5.658
10	5.849	5.154	3.136	4.761

REFERENCES

Bradley, Michael, "Interfirm Tender Offers and the Market for Corporate Control," Journal of Business, 1980, pp. 345-376.

Crudele, John, "How Investors Sniff Out News," New York Times, August 12, 1986, p. D8.

Holderness, Clifford and Dennis Sheehan, "Raiders or Saviors? The Evidence on Six Controversial Investors," Journal of Financial Economics, 1985, pp. 555-575.

Jarrell, Gregg, "The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge," Journal of Law and Economics, 1985, pp. 151-177.

Jensen, Michael, "Don't Freeze the Arbs Out," Wall Street Journal, December 3, 1986, p. 26.

Jensen, Michael and R. Ruback, "The Market for Corporate Control: The Scientific Evidence," Journal of Financial Economics, 1983, pp. 5-50.

Keown and Pinkerton, "Merger Announcements and Insider Trading Activity: An Empirical Investigation," Journal of Finance, 1981, pp. 855-869.

Mikkelson, W. and R. Ruback, "An Empirical Analysis of the Interfirm Equity Process," Journal of Financial Economics, 1985, pp. 523-554.

Office of the Chief Economist, Securities and Exchange Commission, The Economics of Any-or-All, Partial and Two-Tier Tender Offers, April 1985.

Poulsen, Annette, "Market Reaction to Corporate Raiders as Individuals," Working Paper, Office of the Chief Economist, Securities and Exchange Commission, 1984.

Rotbart, Dean, "Arbitrager Mulheren Generates Controversy As His Fortunes Rise," Wall Street Journal, July 23, 1986, p. 1.

Stern, Richard and Laura Jereski, "My Cousin Works For This Guy Who...," Forbes, February 10, 1986, pp. 33-34.

APPENDIX A
Sample of Tender Offers Used In Study

Target Firm	Cusip	NA Date	Finance Date
A M F Inc.	1688	850417	850425
Aegis Corp.	7603	840406	840406
Adams Drug Inc.	6203	841002	841004
Amalgamated Sugar Co.	22771	820903	820903
American Sterilizer	30087	840919	841105
Amerace Corp.	23519	840410	840817
American Motor Inns Inc.	27591	840801	840809
American Nat. Res.	28609	850304	850304
ANTA Corp.	36628	831121	831121
Applied Data Resh. Inc.	38159	851118	851118
ARO Corp.	42627	851021	851029
AVCO Corp.	53501	840723	840726
Bache Group Inc.	56357	810319	810319
Bangor Punta	60221	831202	831212
Belco Pete Co.	77419	830404	830414
Braun Engineering	105655	850503	850528
Breeze Corp.	106763	820526	820526
Brunswick Corp.	117043	820125	820125
Buffalo Forge Co.	119529	810102	810107
Bunker Ramo Corp.	120655	810312	810511
Burgess Inds. Inc.	121232	820305	820305
Burns Intl. Sec. Svcs. Inc.	122375	820426	820427
Cannon Mills Co.	137735	820105	820105
Cardiff Equities Corp.	141466	820224	820224
Caressa Group Inc.	141734	841015	841015
Carnation Co.	143483	840904	840904
Cenco Inc.	151303	810903	810903
Central Soya Inc.	155177	850314	850401
Cessna Aircraft Co.	157177	850913	850913
Chieftain Dev. Ltd.	168664	820617	820617
Chilton Corp.	169277	851126	851126
Cities Services Co.	173036	820527	820601
Clausing Corp.	182891	840514	840514
Cluett Peabody & Co. Inc.	189486	850604	850726
Coldwell Banker & Co.	193252	811005	811005
Compugraphic Corp.	204900	811022	811022
Connecticut Nat. Gas. Corp.	207586	810616	810616
Conoco Inc.	208251	810506	810506
Continental Airlines Corp.	210795	810209	810209
Core Labs Inc.	218677	831122	840104
Cox Communications Inc.	224043	850408	850408
Criton Corp.	226745	820824	820824
Crown Zellerbach Corp.	228669	850401	850402
Dan River Inc.	235773	820915	821025
Data Term. Sys. Inc.	238010	820909	830117
Dean Witter Reynolds Inc.	242410	811007	811007

Target Firm	Cusip	NA Date	Finance Date
Delhi Intl. Oil Corp.	246730	810924	810924
Donaldson, Lufkin & Jenrette Inc.	257660	841105	841105
Dorchester Gas Corp.	258198	831125	831202
Easco Corp.	270330	841231	850107
El Paso Co.	283362	821221	821220
Enstar Corp.	293582	840523	840523
Esmark Inc.	296470	840503	840503
Faberge Inc.	302808	840103	840103
Fisher Scientific Co.	338027	810427	810730
Franks Nursery & Crafts Inc.	355352	830128	830128
Friona Inds. Inc.	358685	841203	841203
Frontier Hldgs Inc.	359076	841023	851023
G F Corp.	361614	820125	820125
Garfinckel Brooks Bros Miller	366028	810814	810814
Gas Svc. Co.	367208	830613	830613
Gaylords Natl. Corp.	368226	850411	850424
General Foods Corp.	369856	850924	850927
General Portland Inc.	370514	810623	810623
General Steel Inds. Inc.	370856	811102	811102
Getty Oil Co.	374280	831228	831228
Giddings & Lewis Inc.	375046	820706	820706
Ginos Inc.	376109	810929	820104
Grand Central Inc.	385272	840326	840326
Graniteville Co.	387478	830426	830502
Gray Drug Stores	389280	810805	810805
Great Lakes Intl. Inc.	390662	850312	851011
Guardian Inds. Corp.	401370	840709	850118
Gulf Corp.	402237	840222	840223
M M M Industries Inc.	404245	830816	830819
Marsco Corp.	415864	810126	810126
Meublein Inc.	428182	820729	820729
Mobart Corp.	433728	801215	801215
Horizon Corp.	440416	850626	851007
Informatics General Corp.	456668	850415	850415
Interpace Corp.	460578	830405	830419
Itek Corp.	465632	830114	830114
James Fred S. & Co. Inc.	470245	821101	821101
Jewel Cos. Inc.	477196	840501	840601
Jonathan Logan Inc.	479898	840208	840320
Juniper Pete Corp.	482031	821101	821101
Kentron Intl. Inc.	491160	850122	850122
L F E Corp.	501858	841214	850506
Lane Bryant Inc.	515174	820407	820407
Lenox Inc.	526264	830608	830610
Levi Strauss & Co.	527364	850711	850711
Levitz Furniture Corp.	527480	840601	840628
Lightolier Inc.	532253	810623	810714
Lowenstein M. Corp.	547779	851008	851008
Ludlow Corp.	549662	810630	810716
M G M Grand Hotels Inc.	553012	840925	840925
Malone & Hyde Inc.	561280	840608	840608

Target Firm	Cusip	NA Date	Finance Date
Marathon Oil Co.	565845	811030	811030
Marshall Field & Co.	572342	820316	820316
Masonite Corp.	575379	840223	840326
McGraw Hill Inc.	580628	850502	850324
Means Services Inc.	583393	820122	820226
Mesa Royalty Trust	590660	840515	840515
Michigan Sugar Co.	594729	840409	840410
Midlands Energy Co.	597803	840207	840913
Miller Wohl Inc.	600633	840501	840502
Milton Bradley Co.	601753	840425	840504
Mission Ins. Group Inc.	605080	831101	840216
Mite Corp.	606708	850422	850422
Murphy G.C. & Co.	626643	841015	850423
N I Industries Inc.	629135	850108	850108
Nabisco Inc.	629525	850529	850529
Narco Scientific Inc.	630854	821001	821001
National Can Corp.	635128	840112	840305
National Mine Svc. Co.	636905	821214	821215
Northwest Energy Co.	667446	830808	830808
Northwest Inds. Inc.	667528	840920	840920
Northwestern Mutl Life Mtg. & Rlty.	668137	820923	820923
Norton Simon Inc.	668707	830606	830606
Opelika Mfg. Corp.	683574	810430	810430
Pacific Lumber Co.	694529	850930	850930
Parsons Corp.	702021	840913	840921
Pay Less Drug Stores NW	704301	850114	850114
Peoples Drug Stores Inc.	711021	840228	840228
Petrolane Inc.	716544	840621	840621
Pier 1 Inc.	720279	811123	811130
Pogo Producing Co.	730448	830421	830426
Prentice Hall Inc.	740648	841105	841107
Puritan Fashions Corp.	746316	831114	831114
R E D M Inds. Inc.	749485	840814	840814
Real Estate Invt. Tr. Amer.	755893	821028	821028
Revlon Inc.	761525	850819	850819
Richardson Co.	763121	811030	811102
Richardson Vicks Inc.	763282	850909	850909
Rio Grande Inds. Inc.	767100	841001	841001
S C A Services Inc.	783876	840611	840611
S C M Corp.	784015	850821	850821
S S P Industries	784719	821202	830425
St. Joe Minerals Corp.	790155	810311	810311
St. Regis Corp.	793453	840718	840718
Sav A Stop Inc.	804600	820106	820108
Schlitz Jos. Brewing Co.	806823	820329	820329
Schrader Abe Corp.	808060	840109	840109
Scovill Inc.	810640	841220	841220
Searle G.D. & Co.	812302	850718	850718
Signal Cos. Inc.	826622	850515	850515
Southland Rty. Co.	844521	851021	851021
Spectro Inds. Inc.	847609	850412	850412

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM
RUDOLPH W. GIULIANI

U.S. Department of Justice

RWG:nmq
mc-0516/1a

United States Attorney
Southern District of New York
JUN 18

One Saint Andrew's Plaza
New York, New York 10007

June 15, 1987

Senator Proxmire
Chairman
United States Senate
Committee on Banking, Housing,
and Urban Affairs
Washington, D.C. 20510-6075

Dear Senator Proxmire:

Set forth below are my responses to the supplementary questions propounded by Senator D'Amato relating to the Committee's recent hearing on the securities industry. I appreciate the opportunity provided me by the Committee on Banking, Housing, and Urban Affairs to testify on this very important issue.

Question 1: In 1984, the Insider Trading Sanctions Act, which I sponsored, was enacted. The legislation was designed to provide an effective deterrent to insider trading by increasing the penalties from disgorgement alone to disgorgement plus a civil penalty of up to three times the amount of the profits gained or losses avoided. Although the Insider Trading Sanctions Act was intended to be a deterrent, some of the largest and most egregious insider trading cases have been prosecuted since that time.

Question 1a: In light of the recent prosecutions, do you believe that the civil sanctions imposed by the Insider Trading Sanctions Act need to be increased?

Answer: No. I believe potential treble damages civilly, along with the alternative fine provision of the 1984 Comprehensive Criminal Act, which provides the option of fines for offenses after January 1, 1985 of double the profit, are adequate.

RWG:nmq
mc-0516/1a

Question 1b: Do we really need more severe civil and criminal penalties (5 years and $250,000 fine for each criminal securities law violation) or do we need more cops on the beat to provide a more effective deterrent?

Answer: We need both. The reason we need more severe penalties is to allow the courts to structure sentences to the degree of venality. Most judges are reluctant to impose consecutive sentences. A ten year maximum sentence allows a court to fashion a sentence that is appropriately responsive to either a $50 million crime and a $70,000 crime. Clearly, we need additional resources both at the SEC and the U.S. Attorney's Office. It has become apparent that the most effective response to crimes whose profits are rivalled only by those made by large scale narcotics dealers is to make the threat of incarceration real.

Question 1c: As you know, I have introduced legislation attempting to define insider trading. Pursuant to my attempts, Senator Riegle has asked a panel of securities law experts, including two of this Committee's counsels, to formulate a definition of insider trading. Do you believe that carefully crafted definition of insider trading could facilitate your enforcement efforts - expecially with regard to your ability to bring close cases such as the Foster Winans case? Could you briefly explain your theory of the case and why Winans' alleged violations constitute insider trading?

Answer: Since the Winans case is before the Supreme Court and The Solicitor General is stating the government's views, I think it would be inappropriate for this Office to enter into a discussion of the case on the merits. However, a copy of our brief before the Second Circuit Court of Appeals is enclosed. As I stated before the Committee, we have been able to function well

and prosecute cases effectively without a precise definition. At least in the criminal arena, the so-called "gray" area of insider trading is little more than a post hoc rationalization of criminals that evaporates when measured against the actual facts.

Question 1d: What specific additional steps would you recommend to crackdown of insider trading?

Answer: I would warn against adopting too narrow a view of the criminal problems in the securities industry. A sustained enforcement effort is essential to keep public confidence in the industry and markets. Given the importance of both the securities and commodities industries, I think the public would be best served by the creation of a small but permanent group of criminal investigators with responsibilities solely in these areas. Additional prosecutors are also necessary. This Office historically made a firm commitment to this area and I have increased the resources devoted to it but we are at the limit, given all the other areas of major public concern that we must address.

Question 2: Some commentators have suggested that illegal trading activity will not be stymied until really harsh criminal penalties are imposed on inside traders. How do you respond to those who claim that the civil and criminal penalties imposed upon Levine, Boesky and Siegel et.al. were too lenient? How do you determine (i.e. what factors) the adequacy of the jail sentences which were imposed in these cases since none of these men ever stood trial? If you find during subsequent investigations that any of the individuals involved in the cases which have settled have failed to tell the whole truth, what recourse do you have against them?

Answer: The commentators who have suggested that the settlements were not adequate have come to that position on the basis of unfounded assumptions and a deep-rooted ignorance of the facts. For example,

RWG:nmq
mc-0516/1a

Siegel had personal profits of $700,000 yet settled for a package worth between 6 million to 9 million dollars. There are also, of course, a large, well-funded group of persons and entities in whose interest it is to attack the settlements to undercut the credibility of those who possess information against them.

As for sentences, the court is made fully aware of all criminal conduct of the defendant as well as the value of any cooperation that the defendant has given the United States Attorney's Office and the Securities and Exchange Commission. As Judge Goettel noted in imposing sentence on Levine, he would have given a five to 10 year sentence but for Levine's extensive and valuable cooperation. In light of Levine's cooperation, the judge's sentence was entirely appropriate. In crimes of stealth and deception cooperation is essential for effective law enforcement. Obviously, there are those with a perverted interest to see that cooperators are sentenced heavily to deter cooperation and save their own or their client's hides. It is a standard part of all of this Office's cooperation agreements that a cooperator's intentional failure to tell the truth renders the agreement void and makes him subject to prosecution for all crimes of which this Office is aware.

Question 3: An SEC Office of Chief Economist Study entitled Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation concludes that the increase stock prices and trading volumes of target shares before a takeover announcement due to a number of factors that have nothing to do with illegal insider trading. Do you agree with the findings of this report or do you believe that insider trading is the dominant source of information that spurs a runup in a stock's price before the announcement of a takeover bid?

RWG:nmq
mc-0516/1a

Answer: I cannot answer this question because we do not have sufficient facts on which to base our answer. Moreover, this is not an area that relates to any factor necessary for prosecution.

Question 4: Under the current system of detection, is it more difficult to detect the institutional investor who sporadically trades on inside information or the person who trades illegally on a one shot basis? If it is harder to detect the sporadic institutional trader, are special steps being taken to detech his illegal trades?

Answer: It is difficult to detect both the one shot trader and the sporadic institutional investor if they are not avaricious. Obviously, the one shot trader who buys heavily in deep-out of the money options will be discovered. A one shot trader who buys a small equity position may, in essence, fly under the radar. Where an institutional trader has many positions in different stocks, the stocks selected on insider trading may stand out on other factors - size of positions, time of purchase, profitability - or they may be buried in other trading. Detection greatly depends on the particular facts.

However, what is troubling about the question is the implicit assumption that spotting the trading is somehow the end of the process. In fact, it is only the beginning. The most difficult part of any investigation is tracing the flow of information from the tipper to the tippee who is doing the trading. Because information is an intangible, there is often no conclusive paper trail. The value of cooperation in unravelling the scheme is apparent. So too, is the overwhelming incentive of potential defendants, their lawyers and other advocates to cut cooperation off and dry up sources of information.

RWG:nmq
mc-0516/1a

Therefore, the steps taken are to spot suspicious trades but not necessarily illegal ones because spotting the trading is a preliminary step in the investigations. To this effect, the exchanges, the NASD and the SEC are all constantly updating and refining their methods to spot both types of trading and we believe genuine progress has been made.

Question 5: We have heard that insider trading cases are very difficult to prove. What are the principal problems confronting your efforts to prosecute inside traders? As enforcers and prosecutors could you recommend any legislation which could facilitate your efforts to enforce the laws currently on the books? Should the SEC be allowed to bring criminal as well as civil actions?

Answer: As a factual matter, insider trading is difficult to prosecute because the subject of the crime is an intangible. One of our principal problems in prosecuting these cases is the lack of investigative and prosecutorial resources. As noted earlier, the efficiency and effectiveness of any law enforcement effort would be greatly enhanced with the establishment of a small group (15-20) of permanent criminal investigators to investigate criminal securities and commodities law violations on a full time basis. I think that the most effective step that could be taken to make enforcement of present laws more effective is to have mandatory incarceration as penalties for crimes against the system. Perjury and obstruction of justice are rampant in securities investigations. These crimes are not often prosecutable because of the difficulty of obtaining evidence

RWG:nmq
mc-0516/1a

When convictions are secured, it is our experience that the courts, because they usually are dealing with first time white collar offenders, are extraordinarily lenient. This is totally counter productive and sends the wrong message.

I do not see any need for the SEC to bring criminal actions. This is most effectively done by U.S. Attorney's Offices which have experience in both the criminal law and trial work. There is one situation in which the SEC does bring criminal charges. Currently, when there is a violation of an outstanding SEC consent decree or injunction, the SEC may prosecute the criminal contempt charges. Normally, the agency will ask the appropriate United States Attorney's Office if they are interested in pursuing the matter. For a variety of reasons, from the sometimes technical nature of the violations, to lack of resources, the United States Attorney may permit the SEC to proceed. I think this process should continue.

Question 6: As a result of the increasing internationalization of the securities markets, shouldn't we be focusing on the real threat to our system posed by insider trading which is transactions executed in our securities on overseas markets? Do foreign bank secrecy laws complicate your task to such a degree that they impede the successful prosecution of insider trading cases? What enforcement mechanisms exist to detect and prosecute insider trading conducted offshore? What role can Congress play to increase cooperation between U.S. and foreign authorities in the fight against insider trading? Would the prosecution of these cases be facilitated if the SEC had the power to freeze assets (before they are sent abroad) without first obtaining a court order?

RWG:nmq
mc-0516/1a

Answer: Of course, foreign bank accounts in bank secrecy jurisdictions are a hurdle to insider trading investigations as well as to other criminal prosecutions. The SEC and this Office have had some success in getting information from some jurisdictions but, even then it is a slow process. The internationalization of security markets does pose a threat, particularly in those instances where the American company's stock may also be purchased on overseas exchanges or off those exchanges. These transactions are obviously very difficult to detect. Another hurdle is that most extradition treaties do not cover insider trading, even in those countries such as the United Kingdom where there is mutuality of criminality for the offense. Inclusion of insider trading as an extradictable offense would be helpful. The ability of the SEC to seize assets might be helpful but it is doubtful that the agency would have the evidence of the traders' intent and knowledge to establish a prima facie case on any short notice in the vast majority of instances. The question again seems to be laboring under the misconception that mere discovery of suspicious trading is the entire picture. It is only the triggering process for a sometimes difficult and, because of walls of silence or perjury and obstruction, fruitless investigations.

Question 7: Do arbitrageurs play any useful role in the marketplace? If a firm is acting as an investment adviser or banker in a particular takeover attempt, should it be prohibited from engaging in any arbitrage activity in the securities of the companies involved in the takeover?

Answer: The usefulness of arbitraguers in the marketplace is a question beyond our jurisdiction and expertise. I think clearly, however, a firm acting as an investment banker or

RWG:nmq
mc-0516/1a

adviser in a takeover attempt should be prohibited from engaging in any arbitrage activity in the securities of the companies involved. To do otherwise is to provide a greased path towards the enormous temptation to trade on insider information.

Sincerely,

RUDOLPH W. GIULIANI
United States Attorney

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM

GARY LYNCH

Q. 1. In 1984, the Insider Trading Sanctions Act, which I sponsored, was enacted. The legislation was designed to provide an effective deterrent to insider trading by increasing the penalties from disgorgement alone to disgorgement plus a civil penalty of up to three times the amount of the profits gained or losses avoided. Although the Insider Trading Sanctions Act was intended to be a deterrent, some of the largest and most egregious insider trading cases have been prosecuted since that time.

(a) In light of the recent prosecutions, do you believe that the civil sanctions imposed by the Insider Trading Sanctions Act need to be increased?

A. I believe that the civil penalties provided by the Insider Trading Sanctions Act ("ITSA") are adequate at their current level. While the Commission has yet to litigate to a conclusion an insider trading case in which a treble penalty is requested, the Commission has determined to accept a payment ranging from a one-time to two-time penalty in settlement of actions which have been brought. These payments, some of which have been very large, accomplish the deterrent purposes of the securities laws insofar as civil penalties can achieve those purposes.

(b) Do we really need more severe civil and criminal penalties (5 years and $250,000 fine for each criminal securities law violation) or do we need more cops on the beat to provide a more effective deterrent?

A. For an economic crime such as insider trading, the deterrent effect of enforcement is a function of the probability that a violator will be apprehended and the severity of the sanction that will be imposed. As I indicated in my answer to the preceding question, I believe that the current civil sanctions are adequate. With respect to criminal sanctions, I would note that all of the defendants in insider trading cases have received less than the maximum penalty provided by statute. I would therefore conclude that the current level of deterrence could best be increased by devoting more resources to the surveillance, investigation, and prosecution of insider trading offenses. However, I personally would support legislation which would increase criminal penalties or provide for mandatory jail sentences.

(c) As you know, I have introduced legislation attempting to define insider trading. Pursuant to my attempts, Senator Riegle has asked a panel of securities law experts, including two of this Committee's counsels, to formulate a definition of insider trading. Do you believe that a carefully crafted definition of insider trading could facilitate your enforcement efforts - especially with regard to your ability to bring close cases such as the Foster Winans case? Could you briefly explain your theory of the case and why Winans' alleged violations constitute insider trading?

A. As I stated at the hearing on April 22, while I do not believe that the current law is vague or uncertain, I believe that a carefully crafted definition of insider trading could facilitate the Commission's enforcement efforts. It would be necessary to carefully examine any proposed definition, however, to ensure that it would not create loopholes or increase the burden of proof which the government must satisfy in insider trading cases.

With respect to the Winans case, the Commission's complaint alleged that Winans profited by communicating material, nonpublic information (i.e. the substance and timing of the Wall Street Journal's forthcoming newspaper columns) to the other defendants. The communication of this information violated Winans' duty of trust and confidence to his employer, enabled Winans and his confederates to derive substantial profits, and constituted a fraud that was perpetrated "in connection with" the purchase of securities.

(d) What specific additional steps would you recommend to crackdown on insider trading?

A. It will be necessary to devote substantial resources to conclude the current investigations and any additional cases which flow from them. Prospectively, the Commission and the self-regulatory organizations must continue to improve their surveillance procedures and investigative efforts.

Q. 2. Some commentators have suggested that illegal trading activity will not be stymied until really harsh criminal penalties are imposed on inside traders. How do you respond to those who claim that the civil and criminal penalties imposed upon Levine, Boesky and Siegel, et al. were too lenient? How do you determine (i.e. what factors) the adequacy of the jail sentences which were imposed in these cases since none of these men ever stood trial? If you find during subsequent investigations that any of the individuals involved in the cases which have settled have failed to tell the whole truth, what recourse do you have against them?

A. I believe that the civil disgorgement and fines imposed upon Levine, Boesky and Siegel are at least as large as we would have obtained had we litigated the cases to a successful conclusion. The defendants will also be subjected to multiple private actions for damages.

With respect to the criminal sanctions, only Levine has been sentenced at the present time. The sentencing judge was very specific in stating that the sentence imposed on Levine (two years imprisonment plus a fine of $362,000) would have been larger but for Levine's cooperation with authorities. All settlements, whether civil or criminal, reflect a cost benefit judgment. An accurate assessment of the benefits which the government received from the defendants' cooperation will be possible only after the current investigations have concluded.

The settlement with each of these defendants required that they make complete and accurate disclosure of all information which they possessed concerning insider trading violations or any other type of securities violation. If it is subsequently determined that they have willfully withheld or falsified information, they lose the benefit of their settlement agreement and may be prosecuted for their participation in the undisclosed violations as well as for all the conduct which they have revealed to the Commission. They may also be prosecuted for making false statements to a department or agency of the United States in violation of 18 U.S.C. 1001. Thus, there are strong incentives for a cooperating witness to be completely truthful and candid.

Target Firm	Cusip	NA Date	Finance Date
Speed O Print Bus. Mach.	847660	841023	841023
Sta Rite Inds. Inc.	852308	820524	820524
Stauffer Chemical Co.	857721	850219	850219
Stokely Van Camp Inc.	861504	821119	821223
Suburban Propane Gas Corp.	864473	821208	821208
Sunbeam Corp.	867068	810921	810921
Supron Energy Corp.	868638	820114	820210
Technicolor Inc.	878521	821029	821029
Texas Gas Res. Corp.	882435	830606	830606
Texasgulf Inc	882887	810626	810626
Thiokol Corp.	884102	820719	820719
Torin Corp.	891067	820607	820607
Transway Intl. Corp.	894015	850821	850821
Tymshare Inc.	902384	831118	840227
Unidynamics Corp.	904671	850107	850108
Uniroyal Inc.	909160	850410	850410
United Energy Res. Inc.	910210	850812	850812
United Rlty Invs. Inc.	911900	830725	830725
United States Inds. Inc.	912078	840227	840227
Unocal Corp.	915289	850408	850408
Volume Merchandise Inc.	928720	840514	840611
Vulcan Inc.	929126	840229	840229
Walbar Inc.	931146	851023	851023
Wieboldt Stores Inc.	967613	851003	851120

Q. 3. An SEC Office of Chief Economist Study entitled Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation concludes that the increase stock prices and trading volumes of target shares before a takeover announcement are due to a number of factors that have nothing to do with illegal insider trading. Do you agree with the findings of this report or do you believe that insider trading is the dominant source of information that spurs a runup in a stock's price before the announcement of a takeover bid?

A. It is extremely difficult to isolate the factors which cause price and volume increases in a stock prior to a takeover announcement. I tend to agree with the study's conclusion that many such increases are caused by such factors as a prospective bidder's legal accumulation of shares up to the five percent threshold, trading on the basis of speculation and rumor, and trading by persons who react to the technical performance of a stock. Once a stock that has been the subject of speculation begins to move, it tends to acquire momentum because many people conclude that the movement reflects the existence of an unannounced corporate development. However, it is apparent that in numerous instances insider trading contributed at least in part to a runup in stock price prior to a takeover announcement.

Q. 4. Do you believe that lowering the Schedule 13D reporting acquisition threshold from 5% to 3% or lower could have any impact on the incidence of insider trading?

A. Although legislation to lower the Schedule 13D reporting threshold might be useful for other purposes, it should not be assumed that such legislation would have a significant impact on the incidence of insider trading. Agents of a prospective bidder could leak nonpublic information prior to reaching a three percent threshold just as easily as they can now leak such information prior to reaching a five percent threshold. Reducing the reporting deadline from the current ten day period would probably have a greater impact, because it would limit the length of time during which persons could take advantage of nonpublic information.

Q. 5. The first line of defense against insider trading should be the in-house policies and procedures of firms that regularly engage in securities transactions. My perception of these in-house, self-policing mechanisms is that they are illusory and these firms are paying lip service to their commitment to eradicate insider trading. I have introduced legislation that would, under certain circumstances, impose civil penalties upon firms for an employee's violations of the federal securities laws. Do you believe that these firms would have a greater incentive to formulate and implement self-policing mechanisms if the firm was civilly liable for the actions of their employees if they knew or should have known that their employees were trading on inside information? What, if any, provisions of the law permit the SEC to prosecute firms for the actions of their employees? What are the limitations of these laws regarding your ability to prosecute a firm?

A. Legislation which imposed civil penalties upon firms for an employee's violation of the securities laws would undoubtedly provide an incentive to implement and maintain supervisory procedures. Those firms already have substantial incentives, however, and it should be recognized that there is a limit to any firm's ability to prevent one of its employees from violating the law. For example, Dennis Levine took elaborate steps to conceal his illegal trading activity from his employers.

In recognition of the limits upon a firm's ability to detect violations, any proposed legislation should not impose strict liability upon firms for the violations of their employees. Rather, I believe that liability should be imposed only upon a showing that the firm knew, or should have known, of the employee's violations.

At the present time, the Commission may administratively sanction firms for failing to exercise reasonable supervision over its employees with the view to preventing violations. The Commission has brought failure to supervise cases on a regular basis against both large and small firms. However, in the past these cases have concerned violations other than insider trading.

The Commission may also seek civil penalties under ITSA where the trading is effected in a proprietary account of the firm. In SEC v. The First Boston Corporation, Civ. No. 86-3524 (S.D.N.Y. 1986) and SEC v. Kidder, Peabody & Co., Inc., Civ. No. 87-3869 (S.D.N.Y. 1987), the firms were required to disgorge their illegal profits and pay a civil penalty equal to twice the size of those profits subject to the ITSA penalty. Where an employee trades for his own account, however, it is unclear whether a civil penalty may be imposed against the firm. ITSA provides that a defendant may be held liable for aiding and abetting a violation only if the defendant communicated the nonpublic information to the person who traded.

Q. 6. Since 1981, what percentage of the insider trading cases which have been successfully brought or settled by the SEC have involved market professionals such as investment bankers, investment professionals and broker dealers and what percentage have been brought against corporate officers and directors and their friends and relatives?

A. To respond to this question, the staff reviewed the litigation releases relating to all insider trading cases brought by the Commission in its fiscal years 1981 through 1986. Based upon this review, it is estimated that 52% of the cases involved corporate officers and directors or their friends and associates; 16% involved securities professionals; 13% involved individuals from both groups; and 19% involved individuals in other occupations (e.g., financial printers, law firm employees, and acccountants).

It should be noted that the Commission typically brings administrative proceedings, in addition to injunctive actions, against securities professionals who engage in insider trading. Such administrative proceedings are not reflected in the estimates set forth above.

Q. 7. Recently, the New York Stock Exchange, the American Stock Exchange and the NASD have publicized their efforts to increase market surveillance. What role does the SEC play with regard to coordinating the market surveillance activities of the self-regulatory organizations? What percentage of the insider trading cases brought by the SEC since 1981 have been initiated by the SEC's market surveillance efforts? What percentage of these cases have been brought due to the market surveillance activities of the self-regulatory organizations? How effective are the market surveillance activities of the self-regulatory organizations in detecting insider trading or other illegal trading activity - in short, do these expensive and elaborate technological detection systems really work?

A. The Commission maintains an active oversight program of the self-regulatory organization ("SRO") surveillance systems. This oversight involves both on-site inspections as well as participation by the Commission's staff in efforts to coordinate and improve SRO activities through the Intermarket Surveillance Group ("ISG"). Just recently, for example, the Commission staff assisted the ISG in developing goals and procedures to expedite insider trading referrals from the SROs to the Commission. Generally, Commission inspections have revealed that SRO systems are effective in detecting aberrant trading that might involve insider information, but that the SROs could improve the speed and quality of their investigations of such aberrant trading. The SROs have been responsive in addressing these concerns.

The information provided by an SRO or any other source varies from case to case. In many cases, it consists of nothing more than the names of various persons who purchased a particular security prior to announcement of material news. Sometimes, however, it may include an analysis of a pattern of trading, or evidence of possible relationships between insiders and the persons who purchased or sold the security in question.

As with other types of cases, insider trading cases originate from various sources. Some insider trading cases, for example, originate from complaints or information provided by members of the public. Others are derived from information uncovered in financial fraud cases. Finally, many such cases originate from more than one source. For these reasons, it is difficult to provide precise estimates concerning the source of these cases. Based on a review of insider trading cases brought in the last three fiscal years, however, we estimate that at least 40% of them were based on information provided by an SRO. Information generated by Commission efforts was also a source in approximately 40% of the cases during that period.

Q. 8. Under the current system of detection, is it more difficult to detect the institutional investor who sporadically trades on inside information or the person who trades illegally on a one shot basis? If it is harder to detect the sporadic institutional trader, are special steps being taken to detect his illegal trades?

A. As I noted in my prepared statement, persons who engage in insider trading rarely confess to their crime. The Commission generally brings its cases after accumulating circumstantial evidence that the defendant did in fact possess inside information at the time of his transaction. Where a person engages in insider trading on an isolated basis, it is often possible to argue that an inference should be drawn that the transaction was motivated by inside information because it deviated from the person's trading history. Where a person with no prior experience in the market opens a new account and buys very speculative options, for example, the inference that such person possessed nonpublic information is compelling. A strong inference may also be drawn where a transaction is unusually large in relation to the individual's assets and income.

It is generally more difficult to build a circumstantial case against a professional trader who is continuously in the market. The illegal transactions may not differ in size from the professional investor's normal pattern of trading. Moreover, the professional investor is usually prepared to provide a sophisticated description of factors (other than inside information) that motivated the transactions under investigation.

One step that is being taken to detect insider trading by market professionals is to modify surveillance procedures so that repetitive suspicious trading is detected. Many of the cases brought against professional traders have involved transactions in several different securities. Such cases were developed only after the pattern of insider trading in more than one stock was detected. In such cases, an analysis of the investment banking and law firms involved in the various transactions has allowed the Commission to isolate the source of the trader's information.

Q. 9. Were the trades of Dennis Levine and Ivan Boesky ever identified by the SEC's or SRO's surveillance systems? If so, on how many occasions?

A. Because Dennis Levine traded through an account at Bank Leu International, Limited, a Bahamian subsidiary of a Swiss bank, his identity was not revealed by surveillance systems. Of the 54 securities which Levine was alleged to have purchased while in possession of inside information, self-regulatory organizations provided surveillance reports to the Commission concerning transactions in 24 of the securities. In most instances, these reports merely identified Bank Leu as one among many purchasers prior to the public announcement of the transaction in question. The attached memorandum describes what action the Commission took with respect to such surveillance reports (Attachment A).

With respect to trading by Ivan Boesky, the New York Stock Exchange reviewed trading by Boesky or his entities on at least 26 occasions between 1984 and 1986. Ten of those matters are under investigation by the NYSE. With respect to the 16 surveillance reports received by the Commission, investigations were opened in at least 14 matters. It should be noted that the NYSE did not refer any investigations due to Boesky's trading.

Q. 10. We have heard that insider trading cases are very difficult to prove. What are the principal problems confronting your efforts to prosecute inside traders? As enforcers and prosecutors could you recommend any legislation which could facilitate your efforts to enforce the laws currently on the books? Should the SEC be allowed to bring criminal as well as civil actions?

A. As I noted in my prepared statement, the most difficult problem which the Commission faces in insider trading cases is building a circumstantial case against persons who do not have to create incriminating documents and who are prepared to commit perjury when questioned under oath. In order to alleviate these problems, it is necessary to aggressively prosecute individuals for perjury and obstruction of justice as well as insider trading. I do not believe that it is necessary to provide the Commission with authority to bring criminal actions. The current level of cooperation with the Department of Justice and the various U.S. Attorneys is excellent and insider trading cases that warrant criminal prosecutions are being pursued.

Q. 11. a) As a result of the increasing internationalization of the securities markets, shouldn't we be focusing on the real threat to our system posed by insider trading which is transactions executed in our securities on overseas markets?

A. The Commission's enforcement program primarily focuses upon detecting and investigating alleged insider trading which occurs on the U.S. markets. In cases where insider trading on a foreign exchange originates from the U.S., or where conduct occurs in the U.S. which results in insider trading on a foreign exchange, the necessary jurisdictional requirements are satisfied, and the Commission has the authority to initiate an investigation.

The Commission does not have regulatory authority, however, to oversee foreign markets. This power rests with the local sovereign regulatory authority. Accordingly, the Commission has no means for detecting whether potentially violative transactions have occurred on foreign exchanges. Rather, the Commission has been working with foreign regulators to assist their surveillance of their own markets and the prosecution of insider trading occurring on those markets.

b) Do foreign bank secrecy laws complicate your task to such a degree that they impede the successful prosecution of insider trading cases?

A. Yes. For the past five years the Commission has worked intensively with countries having bank secrecy laws to develop methods for obtaining evidence in insider trading cases. In this regard, a Memorandum of Understanding was reached with Switzerland and a Mutual Assistance Treaty was signed with the Cayman Islands to address these matters. Further, in the Levine case, the Commission was able to develop an agreement which allowed the bank involved to identify its customer notwithstanding Bahamian bank secrecy laws. Development of additional agreements with other countries continues to be a priority.

c) What enforcement mechanisms exist to detect and prosecute insider trading conducted offshore?

A. As discussed in 11(a) above, unless a U.S. broker is involved, off-shore markets are not subject to Commission oversight and thus transactions on those markets are not subject to Commission scrutiny. This does not mean, however, that these markets are not subject to regulation. Indeed, the Commission has recently concluded an agreement with the United Kingdom Department of Trade and Industry, its counterpart in the U.K., which provides for the sharing of surveillance information and for assistance in cases where violations are alleged to occur on the other country's stock exchanges. Through the negotiation of this type of agreement, the Commission is developing a network of securities enforcement authorities who, working together, will be able to protect the integrity of world class securities and the markets on which they are traded.

d) What role can Congress play to increase cooperation between U.S. and foreign authorities in the fight against insider trading?

A. Mutual assistance agreements provide the most effective means for obtaining evidence located outside the U.S. Because the Commission increasingly needs such evidence, the negotiation of cooperative arrangements has become a priority. Foreign governments, such as Switzerland, the United Kingdom and Japan, have already entered into formal cooperative agreements on mutual assistance in surveillance and enforcement matters. However, the agreements -- and the Commission's authority -- are limited in that they make assistance available only where it can be retrieved from an authorities' files or otherwise obtained through voluntary cooperation. In order to compel the production of evidence by issuing investigative subpoenas, the Commission must be conducting an investigation to determine whether there has been a violation of the U.S. securities laws. It may not issue such subpoenas solely for the purpose of assisting a foreign government that is investigating violations of its own laws.

The staff of the Commission is currently drafting for Commission consideration proposed legislation which would authorize the Commission to issue investigative subpoenas for the production of evidence requested by a foreign government

investigating possible violations of its own laws, if that foreign government has entered into an agreement whereby it undertook to provide similar assistance to the Commission on a reciprocal basis. The staff believes that authorization to provide such assistance would constitute a greater incentive for foreign governments to enter into mutual assistance agreements.

e) Would the prosecution of these cases be facilitated if the SEC had the power to freeze assets (before they are sent abroad) without first obtaining a court order?

A. The Commission has obtained freeze orders on several occasions to prevent allegedly illicit profits from fleeing the jurisdiction. Such orders have been obtained only where the evidence was strong enough to initiate a civil action alleging insider trading. The ability to freeze assets without first obtaining a court order would undoubtedly assist prosecution of these cases, but it is questionable whether any legislation of this type could satisfy constitutional due process requirements.

Q. 12. Published reports regarding the Boesky case imply that the SEC miscalculated the illegal profits that Boesky earned. These reports state that Boesky illegally earned $203 million, not the $50 million figure claimed by the SEC. To the extent you can discuss the case, could you please explain how the SEC calculated Boesky's profits and arrived at the $50 million figure?

A. The Commission intended the $50 million in disgorgement to reflect the profits which entities which Boesky controlled derived from the transactions alleged in the Commission's complaint to have been made while Boesky possessed inside information obtained from Dennis Levine. One newspaper article reported that Boesky had derived profits of $203 million from such transactions. That calculation was apparently based on Boesky's total profits from his positions in the stocks named in the Commission's complaint. In some instances, however, the Commission alleged that Boesky had acquired material nonpublic information after he had already taken a position in the stock. Because his initial investment was not made while in possession of inside information, the Commission sought disgorgement of only those profits derived from transactions made by Boesky after he received inside information.

Q. 13. Do arbitrageurs play any useful role in the marketplace? If a firm is acting as an investment adviser or banker in a particular takeover attempt, should it be prohibited from engaging in any arbitrage activity in the securities of the companies involved in the takeover?

A. Arbitrageurs provide liquidity in highly volatile market situations and thus gave investors the opportunity to minimize their risks. Thus, I believe that arbitraguers do have a useful role.

Under the procedures in effect at most major firms, the corporate finance or investment banking personnel are forbidden from communicating confidential client information to persons within or without the firm except as necessary to serve a client. Depending on the firm's procedure, the communication of such information may be restricted to senior personnel, such as department heads, or it may have to receive prior approval from the firm's legal department.

A restricted list policy may also be used to prohibit certain research, sales, and trading activities in the securities of companies for which it performs corporate finance services. The scope of the activities restricted with respect to securities on the list may vary depending on the firm's policy and the circumstances of the case, but I am aware of no firm which has a policy which would allow the firm to arbitrage a stock which appears on the restricted list.

In 1980, the Commission adopted rule 14e-3 under the Williams Act to forbid trading in securities sought in a tender offer by persons in possession of material nonpublic information concerning the tender offer. The Commission included rule 14e-3(b) as a safe harbor for institutional traders. This exemption is available if the institution can show:

(1) that the person who made the investment decision for the institution did not know the material nonpublic information; and

(2) that the institution had implemented reasonable policies and procedures to ensure that individuals who make investment decisions for the institution do not trade while actually in possession of material nonpublic information.

The Commission's endeavor in rule 14e-3 to exempt institutions from liability when proper procedures are in place received approval in the House Report accompanying the Insider Trading Sanctions Act of 1984. See H.R. Rep. No. 93-355 at 11 (1984).

ATTACHMENT A

MEMORANDUM OF THE DIVISION OF ENFORCEMENT
CONCERNING SURVEILLANCE OF TRADING IN
SECURITIES PURCHASED BY DENNIS LEVINE

May 15, 1987

This memorandum describes what action the Commission took with respect to surveillance reports relating to trading in securities that the Commission ultimately alleged were the subject of insider trading by Dennis Levine and others in SEC v. Dennis Levine, et al., 86 Civ. 3726 (R.O.) (S.D.N.Y. 1986).

Background

The Commission alleged that Dennis Levine made $12.6 million between 1980 and 1986 by trading in the securities of at least 54 issuers while in possession of material, nonpublic information about actual or proposed tender offers, mergers, leveraged buyouts and other business combinations. Levine effected these transactions through Bank Leu International, Limited ("BLI"), a Bahamian subsidiary of a Swiss bank. The individual who acted as a broker for Levine's trades through BLI was also named as a defendant in the Levine case.

The repetitive pattern of Levine's trading over a six-year period has raised questions whether the trading had been detected prior to May 1986. The New York Stock Exchange ("NYSE") advised the Subcommittee that it forwarded 21 surveillance reports concerning trading in securities that ultimately were included

in the Commission's complaint against Dennis Levine. The National Association of Securities Dealers ("NASD") forwarded surveillance reports concerning trading in three of the securities that ultimately were included in the Commission's complaint.

Although these surveillance reports did focus on trading in securities that were involved in the Levine case, the reports did not focus exclusively upon trading by BLI. At least six of the NYSE reports did not refer at all to trading by BLI, and most of the others merely identified BLI as one among many purchasers prior to the public announcement of the transaction in question.

Commission Investigations

The Commission investigated trading in 13 of the 21 securities that were the subject of NYSE surveillance reports. Thus far, those investigations have resulted in three significant enforcement actions that are unrelated to the Levine case. Five investigations are continuing, and five have been closed without enforcement action by the Commission. The Commission initiated an investigation of trading in one of the three stocks that were the subject of NASD surveillance reports. That investigation was closed without enforcement action.

The majority of the Commission's investigations stemming from NYSE surveillance reports concerned trading by parties other than BLI. However, in several investigations that were closed without enforcement action during 1981 and 1982, the staff did focus on transactions by BLI. In one of those investigations, the staff attempted unsuccessfully to obtain information from BLI regarding the identity of a customer who had made approximately $32,000 by purchasing shares of a target company shortly before the commencement of a tender offer. BLI refused to provide any information that would reveal the identity of the customer. Four other banks located in jurisdictions with bank secrecy laws also refused voluntarily to provide information in that investigation.

Because the U.S. securities laws provide generally that the Commission's investigative subpoena power extends only to the production of documentary and testimonial evidence "from any place in the United States or any state," the Commission could not compel the production of this information by issuing an investigative subpoena to BLI.

The transactions through BLI that were scrutinized were purchases of common stock, as opposed to options, and they were not unusually large for an institutional investor. They were suspect only due to their timing. Without the ability to determine the identity of the person or persons directing the

trading through BLI, the staff could not establish that any particular transaction represented trading by a person who possessed material, nonpublic information simply because it originated from a foreign bank.

During the same period as these investigations involving trading by BLI, the Commission was litigating the Santa Fe and St. Joe cases involving insider trading through Swiss banks. 1/ The Commission brought both of those actions without having ascertained the identity of the persons who traded through the Swiss banks. In one of the cases, the Commission obtained a court order compelling a Swiss bank to disclose the identity of its customers notwithstanding Swiss bank secrecy laws. In the other, the Commission successfully obtained the information pursuant to the 1977 Treaty on Mutual Assistance in Criminal Matters between the United States and Switzerland.

The alleged trading profits in the Santa Fe and St. Joe cases were $6.1 million and $1.4 million, respectively, and the circumstances surrounding the trading created a strong inference that the "unknown purchasers" had possessed material,

---

1/ SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corp., 81 Civ. 6553 (S.D.N.Y. 1981); SEC v. Banca Della Svizzera Italiana, 81 Civ. 1836 (S.D.N.Y. 1981). Both cases are described at pages 20 to 22 of your written statement to the Subcommittee for the December 11, 1986, hearings.

nonpublic information. The profits which Levine derived from his insider trading transactions through BLI between 1980 and 1982 ranged from $4,093 to $212,628, and averaged approximately $55,000 per security. The staff's willingness to recommend the filing of lawsuits in Santa Fe and St. Joe without knowing the identity of the ultimate purchasers was based in part on the much larger amount of profits derived through the foreign accounts, as well as other circumstances surrounding the transactions.

The staff's decision not to pursue the BLI trading by resorting to litigation was also influenced by negotiations with Swiss officials that led to the 1982 Memorandum of Understanding (the "MOU") between the United States and Switzerland. These negotiations resulted from the Santa Fe and St. Joe cases. Due to their delicate nature, the staff did not want to use judicial process to compel disclosure by foreign banks while the negotiations were pending. The successful negotiation of the MOU has greatly assisted the Commission's ability to penetrate Swiss bank secrecy laws in insider trading investigations without seeking court orders that are viewed by other countries as an infringement on their sovereignty.

The MOU also established a precedent for obtaining information with the cooperation of foreign government officials. During the investigation preceding the Levine case, the Commission

worked with the Bahamas Attorney General to obtain information relating to Levine's trading through BLI. The Commission obtained the requested information after the Bahamas Attorney General provided BLI with written assurances that its release of such information would not violate Bahamian bank secrecy laws.

Commission Enforcement Actions

As noted above, the NYSE surveillance reports led to three significant cases unrelated to the Levine case. One case which originated from a NYSE surveillance report was SEC v. Stephen G. Karanzalis, et al., 84 Cir. 2070 (CLB) (S.D.N.Y. 1984). In that case, the Commission alleged that two document proofreaders and a word processor at a large New York law firm misappropriated material, nonpublic information about pending takeovers from confidential documents, and conveyed that information to others for the purpose of trading securities in exchange for payments of money. All seven defendants in the case consented to permanent injunctions and agreed to disgorge their illegal profits. In addition, six defendants pled guilty to criminal charges.

The Commission's case in SEC v. Manohar Lal Madan, et al., 83 Civ. 5053 (MEL) (S.D.N.Y. 1983), also involved trading in a security that was the subject of a NYSE surveillance report.

In the Madan case, the Commission alleged that Manohar Lal Madan, a word processor at another large New York law firm, improperly disclosed confidential, nonpublic information about pending takeovers to the other defendants named in the case, and that all of the defendants traded while in possession of that information. The Commission obtained permanent injunctions against thirteen defendants, including Madan. Madan and one other defendant also pled guilty to criminal charges, and each was sentenced to six months inprisonment.

The NYSE also identified the trading which led to the filing of SEC v. Melvin N. Pomerantz, 86 Civ. 9499 (PNL) (S.D.N.Y. 1986), in which the Commission alleged that the defendant purchased securities while in possession of material, nonpublic information concerning a proposed leveraged buyout of SFN Companies, Inc. The Commission alleged that Pomerantz misappropropriated the information concerning the buyout offer from an investment banking firm, in breach of a duty of trust or confidence, and that his mother-in-law also purchased SFN stock on his recommendation. Without admitting or denying the allegations in the complaint, Pomerantz consented to a permanent injunction and agreed to disgorge $39,925 in profits that he and his mother-in-law derived from the transactions. Pomerantz also agreed to pay a civil penalty of $79,850 under the Insider Trading Sanctions Act.

Conclusion

The successful prosecution of the Levine case required both the detection of a trading pattern and a method for obtaining the necessary evidence to sustain the charges. The Commission is now in a much better position to detect and prosecute cases of this type than it was five years ago.

Over the past several years, market surveillance has improved in important respects. First, the SROs meet regularly through the Intermarket Surveillance Group to improve coordination of surveillance efforts. Second, market surveillance groups have become increasingly sensitive to repetitive suspicious trading by the same persons or entities. Both the New York and American Stock Exchanges have, in recent years, detected suspicious patterns of transactions which led to successful enforcement actions following referral to the Commission. 2/ With the benefit of surveillance and enforcement experience, both the SROs and the Commission are continuing to improve their ability to detect insider trading.

The Commission's ability to obtain evidence from foreign countries has also improved dramatically over the past several years. By seeking the cooperation of officials in other countries, as it did in the Levine case, the Commission has acquired the necessary information quickly without resorting to confrontational measures.

2/ SEC v. Sarzynski, 85 Civ. 3864 (S.D.N.Y. 1985) (NYSE referral); SEC v. Brant, 84 Civ. 3470 (S.D.N.Y. 1984) (AMEX referral).